

KEY EMPLOYEE TRUSTS UNDER THE FAMILY OFFICE RULE

Since the Commission's adoption of rule 202(a)(11)(G)-1 (the "Family Office Rule") under the Investment Advisers Act of 1940 (the "Advisers Act"), the Division has received a variety of questions about whether certain key employee trusts would qualify as family clients under the rule. This guidance shares the Division staff's views on these questions.

Background

The Family Office Rule provides an exception from the Advisers Act definition of investment adviser for families that are managing their own wealth, meaning, among other things, that they are providing advice solely to "family clients." Recognizing the need for family offices to attract and retain talented investment professionals as employees, the Family Office Rule permits family offices to include as family clients certain non-family members, including those employees whose position and experience should enable them to protect themselves ("key employees") and certain investment entities through which those key employees may invest in opportunities connected to the family office. Included in the category of key employee investment entities that would meet the definition of a family client is "[a]ny trust of which: Each trustee or other person authorized to make decisions with respect to the trust is a key employee; and each settlor or other person who has contributed assets to the trust is a key employee or the key employee's current and/or former spouse or spousal equivalent... ."¹

Division staff has been asked whether certain trust decision-making powers can be bifurcated between a key employee and a non-key employee. Division staff has also been asked whether the key employee who contributed assets to the trust must also be the key employee authorized to make decisions with respect to that trust. The Division staff's view on each of these issues is discussed below.



Rule Focus on “Investment” Decisions

Staff believes it is within the intent of the Family Office Rule for a non-key employee to make administrative decisions for a trust, provided investment decisions are made by a key employee. The Commission stated in the Release adopting the Family Office Rule that “it is appropriate to allow the family office to advise trusts for which the key employee is the sole person making *investment* decisions” (emphasis added).² The Commission also noted that this approach tracks a parallel concept included in the definition of “qualified purchaser” under the Investment Company Act of 1940 and provides “consistency in entities considered not to need investor protection under our rules because *investment* decisions are made solely by individuals that we have already concluded should have sufficient financial experience and sophistication to act without the protection provided by our regulations” (emphasis added).³ Accordingly, we believe that a trust may qualify as a “family client” if a non-key employee makes *non-investment* decisions for the trust. This interpretation also is consistent with previous staff guidance with respect to the definition of qualified purchaser.⁴

The Advisers Act does not contain a definition of “investment decision.” However, the staff believes that, for example, the following generally are purely administrative duties and do not involve making “investment decisions”:

- preparing and filing taxes for the trust;⁵
- keeping records for the trust; or
- distributing periodic statements or disclosures to trust beneficiaries.

While these and other administrative duties may result in a non-key employee making certain decisions on behalf of the trust, the staff would generally not consider such decisions to be *investment* decisions.

Bifurcation of Decision-making Powers Between Different Key Employees

Additionally, staff believes it generally is consistent with the intent of the Family Office Rule for one key employee to make investment decisions on behalf of another key employee’s trust. The Family Office Rule requires that each trustee or other person authorized to make decisions with respect to the trust is a key employee. In this case, investment decisions would continue to be made solely by a key employee—individuals that the Commission has already concluded should have sufficient financial experience and sophistication to act without the protection provided by its regulations.

Endnotes

- 1 Rule 202(a)(11)(G)-1(d)(4)(x). The staff notes that certain other key employee investment entities may also meet the definition of family client, including “[a]ny irrevocable trust in which one or more other family clients are the only current beneficiaries” and “[a]ny revocable trust of which one or more other family clients are the sole grantor.” Rule 202(a)(11)(G)-1(d)(4)(vii) and (ix).
- 2 See *Family Offices*, Investment Advisers Act Release No. 3220 at 37990 (June 22, 2011) [76 FR 37983 (June 29, 2011)] (“Adopting Release”).
- 3 *Id.*
- 4 See *American Bar Association Section of Business Law*, SEC Staff Letter (Apr. 22, 1999) at Question C.2, fn. 40 and accompanying text, in which the staff stated its belief that, with respect to the subsection of the qualified purchaser definition relating to trusts, the requirement that “the trustee or other person authorized to make decisions with respect to the trust” be a qualified purchaser would be met in the case of multiple trustees so long as the trustee responsible for making investment decisions with respect to the trust was a qualified purchaser.
- 5 We note, however, that certain other tax-related activities, such as providing advice on structuring a tax-favorable investment strategy, would not be purely administrative.

This *IM Guidance Update* summarizes the views of the Division of Investment Management regarding various requirements of the federal securities laws. Future changes in laws or regulations may supersede some of the discussion or issues raised herein. This *IM Guidance Update* is not a rule, regulation or statement of the Commission, and the Commission has neither approved nor disapproved of this *IM Guidance Update*.

The Investment Management Division works to:

- ▲ protect investors
- ▲ promote informed investment decisions and
- ▲ facilitate appropriate innovation in investment products and services through regulating the asset management industry.

If you have any questions about this IM Guidance Update, please contact:

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