

FAMILY WEALTHREPORT

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Be Ready For Change: Dodd-Frank And The Family Office

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For wealthy families, the Dodd-Frank Wall Street Reform and Consumer Protection Act could be a game changer similar to the impact the Sarbanes-Oxley Act had on the business community in the aftermath of Enron and WorldCom affairs.

The new legislation and regulations will require families to expand their planning efforts, both for their businesses and family offices. The big question it now raises for families is how to structure their investment activities going forward.

The Act eliminates an exclusion from the Investment Advisers Act of 1940 for investment advisors with fewer than 15 clients. Many family offices had relied upon this exclusion from the definition of “investment advisor” in connection with their providing investment advice to family members and related entities. Instead, the new legislation exempts family offices, but leaves it up to the Securities and Exchange Commission to define what a “family office” is.

Historically, many family offices have received an exemption from registration from the SEC for their pooled investment vehicles based on various factors, including their serving the direct lineal descendants of a single founder. It remains to be seen whether the SEC will continue to use those factors in arriving at a definition of family office. So, the future of those exemptions is uncertain.

Most of the Act’s ramifications for families and their family offices will be determined through a lengthy SEC rule-making process. It is difficult to predict the outcome, but the best-case scenario will be the retention of the status quo - and there is a possibility of increased regulation for family offices. Worth noting as well, because the SEC may be so overwhelmed and understaffed by its broad new duties and responsibilities, it may delay acting on the matter. Whichever, we strongly suggest that despite the uncertainty, families begin a process of analyzing their options and developing a plan for how to proceed under the different potential outcomes.

In the event that the SEC does, in fact, remove the old exemptions, it is possible that family offices will have to decide whether to become a regulated entity or to find trusted partners that can provide investment advice to their families.

This requires a major strategic decision, and each family should carefully consider its mission, values and resources as it analyzes the costs and complexity accompanying both paths. The upside for families of either becoming a regulated entity or partnering with one is that the compliance activities associated with regulatory oversight will introduce discipline to maintain best practices.

Choosing the regulated entity option means becoming a Registered Investment Advisor with accompanying SEC regulation for those with more than \$100 million in assets under management, or state regulation for those with less than \$100 million in assets under management.

Yet another possibility is to become a private trust company under state banking regulation. Families that choose to establish their own private trust companies will thus avoid SEC registration. Becoming a private trust company provides an excellent platform and regulatory structure for families to support their complex wealth structures in a fully integrated fashion. But families need to be aware of the significant investment of resources - time, expertise and capital - required to start and maintain a private trust company that supports, rather than jeopardizes, a family's legacy.

Family offices serve an important role in helping families flourish - in terms of wealth, family values and contributions to their communities. Family offices create a level of privacy that families value deeply, while providing objective and integrated advice to help them manage the relationship between their wealth and succeeding generations. I hope that the SEC's rule-making process enables family offices to continue to serve families without undue burden.

Where there is uncertainty there is opportunity. Family leaders would do well to study the law, reach out to their advisors, and closely monitor the actions of the SEC. Now is the time for families and their family offices to develop meaningful plans for the future.