

PRIVATE TRUSTEES BEWARE: A REVIEW OF THE
SWEEPING NEW SEC REGISTRATION
REQUIREMENTS UNDER THE DODD-FRANK WALL
STREET REFORM AND CONSUMER PROTECTION
ACT

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INTRODUCTION

The 2010 passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) rocked the finance and wealth management industries by imposing one of the most far-reaching financial regulatory schemes in U.S. history. The sprawling Act spans from hundreds to thousands of pages (depending on who you ask)¹ and may give rise to thousands of pages of new federal regulations.² The Act calls for up to 400 new regulations, only 25% of which have yet been written.³ Some of the Dodd-Frank Act's better-known provisions include the formation of the Volcker Rule, the creation of the Financial Stability Oversight Council and the Consumer Financial Protection Bureau, the imposition of new regulations on securitization and derivatives markets, and the introduction of new supervision of non-bank financial institutions by the Federal Reserve.

Many trustees, particularly private trust companies and other fiduciaries of family offices may be unaware that the Dodd-Frank Act applies to them. A family office is an entity created by a wealthy family for the purpose of managing family wealth, financial planning, and the provision of

1. Compare Greg MacSweeney, *H.R. 4173 (Dodd-Frank): A 'Page Turner,'* WALL ST. & TECH., Feb. 1, 2011, at 6, 6, available at <http://wallstreetandtech.com/regulatory-compliance/229216568> (describing the Act's length as 848 pages), with Lisa A. Rickard, *One Year after Passage, Warning Flags Fly for Hurricane Dodd-Frank*, METROPOLITAN CORP. COUNS., Sept. 1, 2011, at 5, 5, available at <http://www.metrocorp-counsel.com/articles/15292/one-year-after-passage-warning-flags-fly-hurricane-dodd-frank> (stating the Act is 2,319 pages in length).

2. See generally Heather Draper, *Regulatory Burdens Weigh Down Banks*, DENVER BUS. J., Sept. 16, 2011, available at <http://www.bizjournals.com/denver/print-edition/2011/09/16/regulatory-burdens-weigh-down-banks.html>.

3. Edward Wyatt, *Dodd-Frank Act a Favorite Target for Republicans Laying Blame*, N.Y. TIMES, Sept. 21, 2011, at B1.

other services to a family.⁴ Often, a family office or private trust company will qualify as an “investment adviser” because it receives compensation in exchange for providing securities advice.⁵ In the past, many family offices and trustees of private trusts avoided mandatory registration under the Investment Advisers Act of 1940 (the IAA) because they qualified as private advisers, which were exempt from registration.⁶ Family offices could also avoid registration by obtaining an exemptive order from the Securities and Exchange Commission (SEC) if the SEC determined that, while the office met the requirements of an “investment adviser,” the intent of the IAA did not indicate a need for the particular office to register with the SEC.⁷

Since July 21, 2011, the Dodd-Frank Act has eliminated the private investor exemption.⁸ As such, many family offices, unregulated private trust companies, and individuals serving as trustee may now be subject to mandatory SEC registration as investment advisers.⁹ Trustees of private trusts must now determine whether they must register as investment advisers with the SEC and, if so, what steps they can take to avoid registration. Many non-grandfathered family offices can continue to avoid SEC registration by qualifying under the newly created exception for family offices. To fall within the exception, a family office must provide securities advice only to members of a single family, be managed and controlled by requisite family members and entities, and not hold itself forth to the public as an investment adviser.¹⁰

First, this article discusses the Dodd-Frank Act in general. Next, it examines prior registration requirements imposed by the IAA, as well as the exceptions for banks, state-regulated trust companies, lawyers and other professionals. It then examines how the Dodd-Frank Act has changed investment advisor registration requirements, including the new family office exception, limited intrastate exemption, and newly created private fund adviser exemption. Next, it discusses state regulation. Finally, this article ad-

4. Family Offices, Investment Advisers Act of 1940 Release No. 3098, 75 Fed. Reg. 63,753 (Oct. 12, 2010).

5. See Joseph Nameth, SEC No-Action Letter, 1983 WL 30256 (Jan. 31, 1983).

6. NORA JORDAN ET AL., ADVISING PRIVATE FUNDS: A COMPREHENSIVE GUIDE TO REPRESENTING HEDGE FUNDS, PRIVATE EQUITY FUNDS AND THEIR ADVISERS § 6:8 (2011).

7. Family Offices, 75 Fed. Reg. 63,753, 63,754 (Oct. 18, 2010) (citing 15 U.S.C. § 80b-2(a)(11)(G)).

8. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1575-76 (2010) (to be codified at 15 U.S.C. § 80b-3).

9. Christopher M. Reimer, *The Undiscovered Country: Wyoming's Emergence as a Leading Trust Situs Jurisdiction*, 11 WYO. L. REV. 165, 191 (2011); Alan V. Ytterberg & James P. Weller, *Managing Family Wealth Through a Private Trust Company*, 36 ACTEC L.J. 623, 632 (2010).

10. 17 C.F.R. § 275.202(a)(11)(G)-1(b) (2011).

dresses additional questions regarding whether a manager, general partner, or director of a company may be required to register and the ways in which trustees may be able to avoid registering with the SEC by delegating their powers to registered co-trustees.

THE DODD-FRANK ACT

In 2007, the U.S. economy suffered what has been characterized as the worst financial crisis since the Great Depression.¹¹ While the causes of the crisis remain complex and disputed, the U.S. housing market collapsed in 2006, followed by a rapid decline in value of mortgage backed securities and resulting damage (and sometimes collapse) of important financial institutions. The federal government bailed out a number of financial institutions, the stock market plummeted, consumer wealth declined by estimates as high as billions of dollars, global credit tightened, and economies around the world slowed. The federal government adopted a number of measures in an attempt to mitigate the crisis and lower the risk of its recurrence. Congress passed one of these measures, the Dodd-Frank Act, on July 15, 2010 and President Obama signed the Act into law on July 21, 2010. The Act's primary purposes were "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, [and] to protect consumers from abusive financial services practices."¹²

Some commentators have blamed the 2007 financial crisis, at least in part, on the failure of the federal government to adequately regulate investment professionals. Prior to the Dodd-Frank Act, many hedge funds and private equity advisers avoided registration with the SEC under the IAA by structuring their operations to meet the requirements of the private adviser exemption.¹³ Since hedge fund advisers could treat each fund as a client—regardless of the number of investors investing in the fund or the size of the fund's assets—and even the largest hedge fund managers managed fewer than fifteen funds, many hedge fund advisers could avoid registration.¹⁴ Part

11. Elizabeth C. Peterson, *Navigating the Thorny Path of Corporate Compliance in the Wake of Dodd-Frank*, in SEC COMPLIANCE BEST PRACTICES 53, 54 (2011).

12. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 409, 124 Stat. 1376, 1575-76 (2010) (to be codified at 15 U.S.C. § 80b-3).

13. Karol C. Sierra-Yanez, *Hedge Funds and Increased Regulatory Scrutiny under Dodd-Frank*, 30 No. 3 BANKING & FIN. SERVS. POLICY REPORT 13 (2011); Thierry Olivier Desmet, *Understanding Hedge Fund Adviser Regulation*, 4 HASTINGS BUS. L.J. 1 (2008) (citing 16 U.S.C. § 80b-3(b)(3) (2000)).

14. See *Goldstein v. S.E.C.*, 451 F.3d 873, 877, 879-80 (D.C. Cir. 2006) (vacating an SEC rule extending registration to hedge fund advisers and holding that each fund, rather than each investor, shareholder, or partner, is a client for the purposes of the IAA); Thomas

of the blame for the 2007 financial crisis was attributed to the manner in which hedge funds exposed banks to large risks.¹⁵ According to this argument, part of the problem was caused by the fact that such activity took place through private affiliates, which was not transparent to regulators.¹⁶ The private adviser exemption created a so-called “shadow financial system” in which regulators did not have access to information about trades and portfolios that they needed to determine systemic risks.¹⁷ The Dodd-Frank Act attempted to address this problem by removing the private adviser exemption that had allowed many advisers to private funds to avoid reporting to the SEC.¹⁸ According to a summary of the Dodd-Frank Act provided by the U.S. Senate, “This data will be shared with the systemic risk regulator, and the SEC will report to Congress annually on how it uses this data to protect investors and market integrity.”¹⁹

Many private trustees may not realize that the Dodd-Frank Act requires them to register for the first time either with the SEC or with state securities regulators pursuant to the IAA. The Dodd-Frank Act makes important changes to the IAA that became effective on July 21, 2011. The most significant change is the elimination of the “private adviser” exemption previously relied upon by many family offices, trustees of private trusts, private trust companies, hedge funds, and other investment advisers who would otherwise have been required to register with the SEC. The exemption applied to investment advisers who (i) had fewer than fifteen clients in the past twelve months, (ii) did not hold themselves out generally to the public as investment advisers and (iii) did not act as an investment adviser to a registered investment company or business development company.²⁰ Any individuals or entities relying on the private adviser exemption on July 21, 2011 must find another exemption or register as an investment adviser under the IAA (unless a transition period applies).

R. Stephens, *Dodd-Frank Act Expands Federal and State Regulation of Investment Advisers*, COLO. LAW., Feb., 2011, at 15; STAFF REPORT TO THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS 21 (2003), <http://www.sec.gov/news/studies/hedgefunds0903.pdf>.

15. Steven A. Ramirez, *Dodd-Frank as Maginot Line*, 15 CHAP. L. REV. 109, 123 (2010).

16. Ramirez *supra* note 15, at 123–24.

17. U.S. SENATE, BRIEF SUMMARY OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (2010), http://banking.senate.gov/public/_files/070110_Dodd_Frank_Wall_Street_Reform_comprehensive_summary_Final.pdf.

18. Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less than \$150 Million in Assets Under Management, and Foreign Private Advisers, 76 Fed. Reg. 39,646, 39,647 (July 6, 2011) (to be codified at 17 C.F.R. pt. 275).

19. U.S. SENATE, *supra* note 17.

20. 15 U.S.C.A. § 80b-3(b)(3) (West 2011).

WHO IS AN INVESTMENT ADVISOR?

General Definition

The Dodd-Frank Act did not change the underlying definition of an “investment adviser.” Pursuant to the IAA, any individual or entity acting as an investment adviser must register with the SEC unless an exemption applies.²¹ The IAA definition of “investment adviser” includes 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 or as to the advisability of investing in, purchasing, or selling securities.”²²

The SEC has identified three elements of an investment advisor. The person must (1) provide advice, or issue reports or analyses regarding securities, (2) be in the business of providing such services, and (3) provide such services for compensation.²³ The SEC “construes the elements of the definition of ‘investment adviser’ broadly.”²⁴

Providing Advice

Through releases and interpretive opinions, the SEC has indicated that providing advice or issuing reports or analyses to others regarding securities includes:

[A]dvice, recommendations, reports or analyses about specific securities; advice about securities generally; advice concerning the relative advantages and disadvantages of investing in securities as compared to other investments; advice as to the selection or retention of an investment manager or managers; and providing a market timing service or offering market timing advice.²⁵

21. *Id.* § 80b-3(a).

22. *Id.* § 80b-2(a)(11). The term “person” includes any natural person or company. *Id.* § 80b-2(a)(16).

23. See *Applicability of the Investment Advisors Act to Financial Planners, Pension Consultants, and other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services*, Investment Advisors Act of 1940 Family Offices, Exchange Act Release No. IA-1092, 52 Fed. Reg. 38,400-01, 38,402-03 (Oct. 8, 1987) [hereinafter Release No. IA-1092].

24. SEC Staff Legal Bulletin No. 11, 2, 2000 WL 34603793 (Sept. 19, 2000).

25. Audrey C. Talley, *Family Offices: Securities and Commodities Law Issues*, 34 ACTEC J. 284, 285 (2009) (citing *Applicability of Investment Advisers Act to Financial*

The SEC has declined to adopt a rule or take a no-action position that would exclude different types of family investment funds owned or controlled by members of a single family from the adviser registration rule requirements.²⁶

Being in the Business

In guidance related to the second element, the SEC has stated that:

[T]he giving of advice need not constitute the principal business activity or any particular portion of the business activities of a person in order for the person to be an investment adviser. The giving of advice need only be done on such a basis that it constitutes a business activity occurring with some regularity.²⁷

The SEC considers a person to be “in the business” of providing investment advice if he:

(1) holds himself out as an investment adviser, (2) receives any separate or additional compensation that represents a clearly definable charge for providing advice about securities, regardless of whether the compensation is separate from or included within any overall compensation, or receives transaction-based compensation if the client implements the investment advice, or (3) on anything other than rare, isolated and non-periodic instances, provides specific investment advice.²⁸

Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Release No. 1092 (Oct. 8, 1987), 52 Fed. Reg. 38,400 (Oct. 16, 1987); College Res. Network, SEC No-Action Letter, 1993 WL 121466 (Apr. 9, 1993); David Parkinson, SEC No-Action Letter, 1995 WL 619930 (Oct. 19, 1995).

26. Talley *supra* note 25, at 285.

27. Release No. 1A-1092, *supra* note 23, at 38,402-03.

28. William A. Lowell & Kristin T. Abati, *Representing Estate and Trust Beneficiaries and Fiduciaries: Registration Under the Investment Advisers Act of 1940*, SN003 ALI-ABA 395, 399 (2007).

Compensation

With respect to the third element, the SEC has stated that the element is satisfied:

[B]y the receipt of any economic benefit, whether in the form of an advisory fee or some other fee relating to the total services rendered, commissions, or some combination of the foregoing . . . The compensation element is satisfied if a single fee is charged for a number of different services, including investment advice²⁹

Trustees

The IAA definition of investment adviser applies to most trustees of private trusts. Some trustees have historically relied on *In re Loring*³⁰ to support the position that they are not in the business of advising *others* with respect to securities and, therefore, do not meet the definition of investment adviser under the IAA.³¹ The SEC found that the trustee in *In re Loring* had legal title to the property and acted as principal; it also found that his services were “not limited to supervision of investments but include[d] all other services ordinarily incident to the ownership and management of property.”³² The SEC further found that the trustee did “not hold himself out as being engaged in the business of giving advice to others as to securities” because he acted on his own behalf as the legal titleholder and principal.³³ Thus, the SEC ruled that the trustee did not meet the definition of an investment adviser under the IAA.³⁴

While the SEC has not rejected *In re Loring*, it has since limited the case’s scope by emphasizing that most of the trustee’s business in that case consisted of acting as a court-appointed fiduciary.³⁵ The SEC has expressed the conflicting view that “a person who, for compensation, engages in the business of investment management with the discretionary power to buy and sell securities is an investment adviser even if such business is operated

29. Release No. 1A-1092, *supra* note 23, at 38,402-03.

30. *In re Loring*, 11 S.E.C. 885 (1942).

31. Lowell & Abati, *supra* note 28, at 401.

32. *In re Loring*, 11 S.E.C. at 886.

33. *Id.*

34. Lowell & Abati, *supra* note 28, at 401.

35. Nameth, *supra* note 5, at *1.

through the medium of trusts.”³⁶ The SEC has adopted a broad definition of compensation and has stated that a trustee accepting fees for administering trusts constitutes compensation for investment advice.³⁷ While one cannot be certain how the SEC would treat the following types of trustees, it appears that they would *not* fall within the definition of an investment adviser:

- Court-appointed trustees;³⁸
- Trustees without discretionary power to buy and sell securities;³⁹ and
- Trustees receiving no compensation or administrative fees.⁴⁰

Despite the absence of a clear rule from the SEC, trustees of private trusts fall within the definition of an investment adviser under the IAA. Therefore, trustees must qualify for an exemption or exception under the IAA unless they are court-appointed, have no discretionary power over the securities of the trust, or receive no compensation of any type.

EXCEPTIONS TO THE DEFINITION OF AN INVESTMENT ADVISOR

Section 202(a)(11) of the IAA expressly excepts some persons from the definition of “investment adviser.” These exceptions have been unchanged by the Dodd-Frank Act.

Exceptions for Banks and State-Regulated Trust Companies

Trust companies subject to state regulation are excluded from the definition of an investment adviser under the IAA. Section 202(a)(11)(A) of the IAA excludes from the definition of investment adviser any bank.⁴¹ The IAA defines the term “bank” to include any banking institution or trust company which (i) is doing business under the laws of any State or the United States, (ii) a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks; and (iii) is supervised and examined by a State or Federal authority having supervision over banks or savings associations.⁴² This ex-

36. *Id.*

37. *Id.*

38. *Id.* See also discussion of *In re Loring*, *supra* notes 30–34.

39. Nameth, *supra* note 5, at *1.

40. *Id.*

41. 15 U.S.C.A. § 80b-2(a)(11)(A) (West 2011).

42. *Id.* § 80b-2(a)(2).

ception will not apply to trust companies that are not regulated by state law, such as unregistered trust companies operating in Nevada or Wyoming.⁴³

Exceptions for Lawyers, Accountants, Engineers, and Teachers

The IAA definition of investment adviser excludes certain professionals. Section 202(a)(11)(B) provides an exception for “any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession.”⁴⁴ The SEC generally interprets this exception narrowly⁴⁵ and has limited the applicability of the lawyer exception through no-action letters and Investment Adviser Releases. The SEC staff holds the view that “the exception contained in Section 202(a)(11)(B) would not be available, for example, to a lawyer or accountant who holds himself out to the public as providing financial planning, pension consulting, or other financial advisory services.”⁴⁶ The advice must be given in connection with the provision of the professional’s services and, therefore, a professional relying on the exception cannot provide investment advice as a separate sideline from his or her profession.⁴⁷

In determining whether a lawyer provides investment advice solely as a service incidental to practicing law, the SEC considers:

- (1) whether the lawyer holds herself or himself out to the public as providing investment advisory services;
- (2) whether the advisory services rendered are in connection with and reasonably related to the lawyer’s contract to provide legal services; and
- (3) whether the charge for such ser-

43. See NEV. REV. STAT. § 669.080(1)(o) (2010); WYO. STAT. ANN. §§ 13-5-101-104 (West 2011).

44. 15 U.S.C.A. § 80b-2(a)(11)(B) (West 2011). There is a similar exception for “any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor.” *Id.* § 80b-2(a)(11)(C).

45. THOMAS P. LEMKE & GERALD T. LINS, REGULATION OF INVESTMENT ADVISERS §1:18 (Thomson West 2010 Edition) available at Westlaw.

46. Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons who Provide Investment Advisory Services as an Integral Component of Other Financial Related Services, Investment Advisers Act Release No. 770, 23 SEC Docket 556, 1981 WL 31106, at *6 (Aug. 13, 1981).

47. LEMKE & LINS, *supra* note 45.

vices is based on the same factors as determine the lawyer's usual charges.⁴⁸

Based on these factors, the SEC has found that the lawyer exception is not available to the following types of lawyers:⁴⁹

- a lawyer who advertises himself in several publications as an “inflation consultant” and provides investment advisory services as such;⁵⁰
- a lawyer who advertises his availability as an “investment and estate planner”;⁵¹
- a lawyer who purports to practice law and give investment advice “in a legal-financial package”;⁵²
- a law firm that would be included in a list of “offeree representatives” for use by potential investors in evaluating purchases of securities pursuant to Rule 146 [now Regulation D] under the Securities Act of 1933;⁵³ and
- a corporation, the principals of which are lawyers, that would advise professional athletes as to the feasibility of entering into contracts for the endorsement of sporting goods, represent them in negotiations as to such contracts, and counsel them as to the advisability of investing in, purchasing, or selling securities.⁵⁴

48. Jan L. Warner, Esq., SEC No-Action Letter, 1988 WL 235358 (Dec. 27, 1988); *see also* Milton O. Brown, P.C., 1983 WL 28750 (Sept. 27, 1983); Thraikill & Goodman, P.C., SEC No-Action Letter, 1982 WL 29458 (July 16, 1982).

49. Thraikill & Goodman, P.C., *supra* note 48.

50. *Id.* (citing Mortimer M. Lerner, SEC No-Action Letter, 1980 WL 14319 (Feb. 15, 1980)).

51. Thraikill & Goodman, P.C., *supra* note 48 (citing Herbert W. Vogelsang, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 81,630 (June 2, 1978)).

52. Thraikill & Goodman, P.C., *supra* note 48 (citing John G. Morrison, SEC No-Action Letter, 1978 WL 12473 (Feb. 25, 1978)).

53. Thraikill & Goodman, P.C., *supra* note 48 (citing Winstead, McGuire, Sechrest & Trimble, SEC No-Action Letter, 1975 WL 22058 (Feb. 21, 1975)).

54. Thraikill & Goodman, P.C., *supra* note 48 (citing Pros, Inc., SEC No-Action Letter, 1973 WL 11814 (Nov. 11, 1973)).

The SEC staff has also directly addressed the question of whether a lawyer acting as a trustee of an estate would be an investment adviser given that he or she possesses legal title to the assets of the estate.⁵⁵ In answer to this question, the Division of Investment Management stated that its position is that “a lawyer receiving any compensation for acting as a trustee, who gives investment advice to the trust with respect to specific securities and whose activities are not incidental to his or her legal practice, is an investment adviser under the [IAA].”⁵⁶

The statutory provision excepting certain lawyers from registration under the IAA also provides an exception for accountants who perform investment adviser functions incidental to their profession.⁵⁷ In accordance with the SEC’s narrow interpretation of Section 202(a)(11)(B), an excepted accountant’s financial advising activity must be truly incidental to accounting and not an independent business. This can prevent accountants who provide certain types of financial planning services from relying on the exception.⁵⁸ Similar to its analysis for attorneys who are exempt from IAA registration, the SEC will examine three factors to determine whether investment advising is “solely incidental” to accounting: whether an accountant holds himself or herself forth to the public as an investment adviser, whether the accountant provides services in connection with and reasonably related to accounting services, and whether the accountant uses the same factors to determine advisory service fees and accounting fees.⁵⁹ The SEC places the greatest weight on whether an accountant holds himself or herself forth to the public as an investment adviser.⁶⁰

Past No Action Letters illustrate how the SEC applies the three-factor test to accountants. For example, the SEC has stated that the following types of accountants must register as investment advisers under the IAA:

55. Clare H. Springs, SEC No-Action Letter, 1990 WL 286952 (Sept. 13, 1990).

56. *Id.*

57. 15 U.S.C.A. § 80b-2(a)(11)(B) (West 2011).

58. LEMKE & LINS, *supra* note 45.

59. Jones & Kolb, SEC No-Action Letter, 1984 WL 45308 (May 7, 1984); Marvin Drabinsky, SEC No-Action Letter, 1984 WL 47318 (Nov. 2, 1984).

60. LEMKE & LINS, *supra* note 45; *see also* Hungerford, Aldrin, Nichols, & Carter, SEC No-Action Letter, 1991 WL 290535, at *2 (Dec. 10, 1991) (stating that an accountant who holds himself forth to the public as an investment adviser must register, regardless of the other two factors).

- An accounting firm that uses a computer program to provide monthly reports about mutual funds with stated investment objectives;⁶¹
- An accountant who charges an hourly fee for professional services and a percentage of assets fee for advisory services;⁶²
- An accounting firm partner who acts as an offeree representative who provides prospective investors with explanations and assistance in connection with the offering of limited partnership interests in an oil and gas partnership;⁶³
- An accountant who makes it known, through stationery, letterhead, a building directory, word of mouth, existing clients, or otherwise, that the accountant acts as an investment advisor or is willing to accept new investment advisory business.⁶⁴

EXCEPTIONS AND EXEMPTIONS CREATED AND CHANGED BY THE DODD-FRANK ACT

Newly Created Family Office Exception

The Dodd-Frank Act creates a new exception to the definition of “investment adviser” under the IAA for any “family office” and directs the SEC to promulgate rules defining the term “family office” in a way that is consistent with previous exemptive orders issued by the SEC and recognizes the range of organizational, management and employment structures and arrangements employed by family offices. Additionally, the Dodd-Frank Act grandfathers into the family office exception persons meeting specific requirements set forth in the Act.⁶⁵ On June 22, 2011, the SEC approved final rule 202(a)(11)(G)-1 under the IAA to define family offices as excluded from the definition of “investment adviser” under the IAA, and

61. Hungerford, 1991 WL 290535, at *1.

62. See Hauk, Sole & Fasani, P.C., SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 78,311 (May 2, 1986).

63. Kenisa Oil Co., SEC No-Action Letter, Fed. Sec. L. Rep. ¶ 77,224 (May 6, 1982).

64. LaManna & Hohman, SEC No-Action Letter, 1983 WL 31009 (March 21, 1983).

65. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 409, 124 Stat. 1376, 1575-76 (2010) (to be codified at 15 U.S.C. § 80b-3).

therefore not subject to the requirements of the IAA.⁶⁶ The rule became effective on August 29, 2011.⁶⁷ The staff of the SEC Division of Investment Management has issued non-binding guidance regarding application of the family office exception.⁶⁸ The final rule contains the following three requirements: (i) it limits the availability of the rule to family offices that provide advice about securities only to certain “family clients”; (ii) it requires that family clients wholly own and “family members or family entities” control the family office; and (iii) it precludes a family office from holding itself out to the public as an investment adviser.⁶⁹

Requirement 1: Family Clients Only

To be excluded from registration under the IAA, a family office must not have any investment advisory clients other than family clients.⁷⁰ Family clients include:

- (i) Any family member;
- (ii) Any former family member;
- (iii) Any key employee, as defined below (hereinafter “key employee”);
- (iv) Any former key employee, subject to the restrictions discussed below;
- (v) Any non-profit organization, charitable foundation, charitable trust (including charitable lead trusts and charitable remainder trusts whose only current beneficiaries are other family clients and charitable or non-profit organizations), or other charitable organization, for which all the funding such foundation, trust or organization holds came exclusively from one or more other family clients;
- (vi) Any estate of a current or former family member or key employee or former key

66. Family Offices, 76 Fed. Reg. 37,983, 37,984 (June 29, 2011) (to be codified at 17 C.F.R. pt. 275).

67. *Id.* at 37,983.

68. U.S. Securities and Exchange Comm’n, Div. of Inv. Mgmt., *Staff Responses to Questions About the Family Office Rule* (Jan. 19, 2012), <http://www.sec.gov/divisions/investment/guidance/familyofficefaq.htm>; U.S. Securities and Exchange Comm’n, Div. of Inv. Mgmt., *Family Office: A Small Entity Compliance Guide* (Nov. 21, 2011), <http://www.sec.gov/rules/final/2011/ia-3220-secg.htm>.

69. 17 C.F.R. § 275.202(a)(11)(G)-1(b) (2011).

70. *Id.*

employee, subject to the restrictions discussed below;

- (vii) Any irrevocable trust in which one or more other family clients are the only current beneficiaries;
- (viii) Any irrevocable trust funded exclusively by one or more other family clients in which other family clients and non-profit organizations, charitable foundations, charitable trusts, or other charitable organizations are the only current beneficiaries;
- (ix) Any revocable trust of which one or more other family clients are the sole grantor;
- (x) Any trust of which: (A) each trustee or other person authorized to make decisions with respect to the trust is a key employee; and (B) 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 who, at the time of contribution, holds a joint, community property, or other similar shared ownership interest with the key employee; or
- (xi) Any company⁷¹ wholly owned (directly or indirectly) exclusively by, and operated for the sole benefit of, one or more other family clients; provided that if any such entity is a pooled investment vehicle, it is excepted from the definition of "investment company" under the Investment Company Act of 1940.⁷²

71. The term "company" as used throughout the family office rule has the same meaning as in section 202(a)(5) of the IAA, which includes "a corporation, a partnership, an association, a joint-stock company, a trust, or any organized group of persons, whether incorporated or not; or any receiver, trustee in a case under title 11, or similar official, or any liquidating agent for any of the foregoing, in his capacity as such." Family Offices, 76 Fed. Reg. at 37,984 n.15.

72. 17 C.F.R. § 275.202(a)(11)(G)-1(d)(4).

Family Member

Under the final rule, the term “family member” includes all lineal descendants of a common ancestor (who may be living or deceased) as well as current and former spouses or spousal equivalents and current and former stepchildren of those descendants, provided that the common ancestor is no more than ten generations removed from the youngest generation of family members.⁷³ This definition of family member allows the family office to select the common ancestor and change that designation over time.⁷⁴ The SEC will not require formal documentation or a procedure to designate or re-designate a common ancestor.⁷⁵ This will allow a family office to shift the family office clientele over time to include either a greater number of current collateral members or a greater number of future lineal members.

Involuntary Transfers

An involuntary transfer of assets to a person who is not a family client (such as a bequest to a friend) does not immediately cause a family office to lose its exclusion from the IAA. Under the final rule, a family office may continue to provide advice with respect to such assets for a transition period of up to *one year* following an involuntary transfer.⁷⁶

Family Trusts and Estates

The final family office rule treats certain family trusts and estates as family clients. First, any irrevocable trust is a family client so long as one or more family clients are the only *current* beneficiaries.⁷⁷ All contingent beneficiaries are disregarded.⁷⁸ The rule also permits the family office to advise irrevocable trusts funded exclusively by one or more family clients, which include non-profit organizations, charitable foundations, charitable trusts or other charitable organizations as current beneficiaries.⁷⁹ Second, a revocable trust is treated as a family client where one or more family clients are the sole grantors, regardless of whether the beneficiaries of the trust are

73. *Id.* § 275.202(a)(11)(G)-1(d)(6). The definition includes children by adoption and current and former stepchildren, as well as foster children and persons who were minors when a family member became their legal guardian. *Id.*

74. Family Offices, 76 Fed. Reg. at 37,985.

75. *Id.* at 37,985 n.27.

76. 17 C.F.R. § 275.202(a)(11)(G)-1(b)(1).

77. Family Offices, 76 Fed. Reg. at 37,986.

78. *Id.* at 37,987. If a non-family client contingent beneficiary becomes an actual beneficiary, the rule’s provisions regarding involuntary transfers will permit “transition of ... advice regarding those assets away from the family office.” *Id.*

79. *Id.*

family members.⁸⁰ Finally, estates of current and former family members and current and former key employees are also treated as family clients.⁸¹ Thus, a family office can advise the executor of a family member's estate even if that estate will be distributed to non-family members.⁸²

Non-Profit and Charitable Organizations

The final family office rule also treats as a family client "any non-profit organization, charitable foundation, charitable trust (including charitable lead trusts and charitable remainder trusts whose only current beneficiaries are other family clients and charitable or non-profit organizations), or other charitable organization," where funded exclusively by one or more other family clients.⁸³ In order to provide a transition period for compliance to family offices that currently advise charitable or non-profit organizations that have accepted funding from non-family clients, family offices have until December 31, 2013 to comply with this restriction.⁸⁴ The rule permits a family charity to be advised by the family office whether it is established and funded by a family member, a family trust, corporation or estate. Further, there is no requirement that a family client originally establish the charitable organization so long as all the funding currently held by the organization originates solely from family clients.⁸⁵

Other Family Entities

Under the final rule, any company, including a pooled investment vehicle, which is wholly owned, directly or indirectly, by one or more family clients and operated for the sole benefit of family clients is treated as a family client.⁸⁶ There is no requirement that family clients *control* such entities.⁸⁷

Key Employees

The final rule treats as family clients certain key employees of the family office, their estates and certain entities through which they may in-

80. *Id.*

81. *Id.*

82. *Id.*

83. 17 C.F.R. § 275.202(a)(11)(G)-1(d)(4)(v) (2011).

84. *Id.* §275.202(a)(11)(G)-1(e)(1). However, a non-profit or charitable organization advised by the family office must not accept any additional funding from any non-family clients after August 31, 2011, except for fulfillment of pledges made prior to that date. *Id.*

85. Family Offices, 76 Fed. Reg. at 37,987.

86. 17 C.F.R. § 275.202(a)(11)(G)-1(d)(4)(xi).

87. Family Offices, 76 Fed. Reg. at 37,988.

vest to allow them to receive investment advice from and benefit from investment opportunities provided by the family office. The rule defines key employee as:

[A]ny natural person (including any key employee's spouse or spouse equivalent who holds a joint, community property or other similar shared ownership interest with that key employee) who is an executive officer, director, trustee, general partner, or person serving in a similar capacity of the family office or its affiliated family office or any employee of the family office or its affiliated family office (other than an employee performing solely clerical, secretarial, or administrative functions) who, in connection with his or her regular functions or duties, participates in the investment activities of the family office or affiliated family office,⁸⁸ provided that such employee has been performing such functions or duties for or on behalf of the family office or affiliated family office, or substantially similar functions or duties for or on behalf of another company, for at least 12 months.⁸⁹

The status of key employees as family clients allows them to invest in family office-advised private funds, charitable organizations, and other family entities. Further, the rule permits the family office to advise trusts where the key employee generally is the sole contributor and the sole person authorized to make decisions with respect to the trust.⁹⁰ However, trusts established by a key employee with his or her lineal descendants or immediate family members as beneficiaries are not considered family clients and cannot be advised by the family office.⁹¹ The definition of key employee does not include spouses, spousal equivalents, or immediate family members, except with respect to a joint property interest, because there is no assurance that these persons have the financial sophistication and experience to protect themselves when receiving advice from the family office.⁹² The final rule also prohibits key employees, their trusts and controlled entities from making additional investments through the family office upon the end of their

88. The regulations define an "affiliated family office" as "a family office wholly owned by family clients of another family office and that is controlled (directly or indirectly) by one or more family members of such other family office and/or family entities affiliated with such other family office and has no clients other than family clients of such other family office." 17 C.F.R. § 275.202(a)(11)(G)-1(d)(1)(2011).

89. *Id.* § 275.202(a)(11)(G)-1(d)(8).

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

91. Family Offices, 76 Fed. Reg. at 37,989–90.

92. *Id.* at 37,990.

employment with the family office, but does not require such former key employees to liquidate or transfer their existing investments held through the family office.⁹³

Multifamily Offices

Family offices serving multiple families do *not* meet the requirements of the rule and are *not* excluded from registration under the IAA as a family office.⁹⁴ Family offices should be cautious not to create a *de facto* multifamily office situation. The SEC has stated that such a *de facto* multifamily office is created and is not excluded from the IAA under the family office rule where several families, unrelated through a common ancestor within ten generations, have established a separate family office for each of the families but have staffed these family offices with the same or substantially the same employees.⁹⁵

Requirement 2: Ownership and Control by the Family

To qualify for the exclusion from registration under the IAA, a family office must be wholly owned by family clients and exclusively controlled, either directly or indirectly, by family members or family entities.⁹⁶ The term “family entity” is defined to include “any of the trusts, estates, companies, or other entities” included in the definition of family client, excluding key employees and their trusts.⁹⁷ The SEC has stated an intention that family offices have the flexibility to structure ownership of the family office for tax or other reasons and has specified that family trusts can own and control the family office.⁹⁸ However, there is a difference between who can own the family office and who must control it. While any family client, including key employees, may hold an ownership interest in the family office, control of the family office must be maintained solely by family members and family entities (*i.e.*, their wholly owned companies or family trusts).⁹⁹ Control is defined 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.”¹⁰⁰

93. 17 C.F.R. § 275.202(a)(11)(G)-1(d)(4)(iv)(2011).

94. Family Offices, 76 Fed. Reg. at 37,991.

95. *Id.* at 37,991 n.114.

96. 17 C.F.R. § 275.202(a)(11)(G)-1(b)(2)(2011).

97. *Id.* § 275.202(a)(11)(G)-1(d)(5).

98. Family Offices, 76 Fed. Reg. at 37,991.

99. *Id.*

100. 17 C.F.R. § 275.202(a)(11)(G)-1(d)(2)(2011).

Requirement 3: Holding Out

Finally, a family office must not hold “itself out to the public as an investment adviser.”¹⁰¹ The SEC believes that such activities “suggest that the family office is seeking to enter into typical advisory relationships with non-family clients.”¹⁰²

Grandfathering Provisions

The Dodd-Frank Act prohibits the SEC from excluding from the definition of family office persons not registered or required to be registered on January 1, 2010 that would meet all of the required conditions of the final family office rule but for their provision of investment advice to certain clients specified in the Act.¹⁰³ This required grandfathering has been incorporated into the final family office rule. Therefore, a family office will qualify for the family office exclusion even if it provides investment advice to (and was engaged before January 1, 2010 in providing investment advice to) the following persons:

- (1) Natural persons who, at the time of their applicable investment, are officers, directors, or employees of the family office who have invested with the family office before January 1, 2010 and are accredited investors, as defined in Regulation D under the Securities Act of 1933;
- (2) Any company owned exclusively and controlled by one or more family members;
or
- (3) Any investment adviser registered under the [IAA] that provides investment advice to the family office and who identifies investment opportunities to the family office, and invests in such transactions on substantially the same terms as the family office invests, but does not invest in other funds advised by the family office, and

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

102. Family Offices, 76 Fed. Reg. at 37,991.

103. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 409(b), 124 Stat. 1376, 1575-76 (2010) (to be codified at 15 U.S.C. § 80b-2).

whose assets as to which the family office directly or indirectly provides investment advice represents, in the aggregate, not more than 5 percent of the value of the total assets as to which the family office provides investment advice.¹⁰⁴

In the event that a family office fails to meet the conditions of the final rule, it will need to qualify for another exemption, seek an exemptive order from the SEC or register under the Act as an investment adviser. However, the SEC has provided a transition period to allow family offices time to determine whether they meet the family office exclusion or to restructure or register under the IAA. Family offices currently exempt from registration under the IAA in reliance on the private adviser exemption that provide investment advice, directly or indirectly, primarily to members of a single family but do not meet the requirements of the new family office exclusion are not required to register with the SEC as investment advisers until March 30, 2012.¹⁰⁵

Limited Intrastate Exemption

The intrastate adviser exemption contained in the IAA is available to

[A]ny investment adviser all of whose clients are residents of the state within which such investment adviser maintains his or its principal office and place of business, and who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange.¹⁰⁶

The term “client” is defined for purposes of the private adviser exemption to include a “trust or . . . other legal organization . . . to which [an investment adviser] provide[s] advice based on its investment objectives rather than the

104. 17 C.F.R. § 275.202(a)(11)(G)-1(c)(2011). However, family offices excluded from registration under the IAA are still deemed to be investment advisers for purposes of paragraphs (1), (2) and (4) of section 206 of the IAA regarding fraudulent and deceptive practices. *Id.*

105. *Id.* § 275.202(a)(11)(G)-1(e)(2).

106. 15 U.S.C.A. § 80b-3(b)(1) (West 2011).

individual investment objectives of its . . . beneficiaries.”¹⁰⁷ Therefore, it appears that the location of the trusts, and not the location of individual beneficiaries, is considered in determining whether all of the clients of a trustee are residents of the state of the trustee’s principal office and place of business.

Effective July 2011, the Dodd-Frank Act narrowed the intrastate adviser exemption by making it unavailable to any investment adviser with a private fund client.¹⁰⁸ See the discussion below regarding the definition of a “private fund.” Therefore, the intrastate exemption is effectively only available to trustees and other investment advisers whose clients (i) reside only in the state of the adviser’s principal office; (ii) hold no securities traded on a national exchange; and (iii) do not include any entities considered private funds under the Dodd-Frank Act.

Newly Created Private Fund Adviser Exemption

The Dodd-Frank Act created a new exemption from registration for investment advisers that act “solely” to private funds and have assets under management in the United States of less than \$150 million (private fund advisers).¹⁰⁹ Such advisers are exempt from registration requirements, but remain subject to recordkeeping and reporting rules to be established by the SEC.¹¹⁰ Therefore, this exemption is less preferable than the others de-

107. 17 C.F.R. § 203(b)(3)-1(a)(2).

108. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 403, 124 Stat. 1376, 1571 (2010) (to be codified at 15 U.S.C. § 80b-3).

109. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 408, 124 Stat. 1376, 1575 (2010) (to be codified at 15 U.S.C. § 80b-3). If an adviser advises any non-private funds, the adviser is not eligible for the private fund adviser exemption. Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less than \$150 Million in Assets Under Management, and Foreign Private Advisers, 76 Fed. Reg. 39,646, 39,667 (July 6, 2011) (to be codified at 17 C.F.R. pt. 275). An exempt private fund adviser may advise an unlimited number of funds, provided that the aggregate value of assets of those private funds is less than \$150 million. *Id.* However, in appropriate circumstances, the SEC may consider two or more separately formed advisory entities that each manages less than \$150 million in assets as a single entity. *Id.* at 39,667 n.314. The Act also created a new exemption for advisers to venture capital funds. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 407, 124 Stat. 1376, 1574-75 (2010) (to be codified at 15 U.S.C. § 80b-3); *see also* 17 C.F.R. § 275.203(l)-1(a) (defining a “venture capital fund”).

110. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 407, 408, 124 Stat. 1376, 1574-75 (2010) (to be codified at 15 U.S.C. § 80b-3) (requiring exempt venture capital fund advisers and private fund advisers to maintain records and submit reports as the SEC deems appropriate, in the public interest, or for the protection of investors).

scribed herein. The private fund adviser exemption applies to most hedge funds, but may also be applicable to other investment vehicles.

The Dodd-Frank Act defines a “private fund” as any issuer that would be an investment company under the Investment Company Act of 1940 (the “ICA”), but for the exemptions provided by Sections 3(c)(1) and 3(c)(7) of the ICA.¹¹¹ The following defined terms are relevant:

Investment Company: “Any issuer which (A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities; (B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or (C) is engaged or proposes to engage in the business of investing, reinvesting, owning, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 percentum of the value of such issuer’s total assets (exclusive of Government securities and cash items) on an unconsolidated basis.”¹¹²

Issuer: any “person who issues or proposes to issue any security, or has outstanding any security which it has issued.”¹¹³

Security: includes any stock, certificate of interest or participation in any profit-sharing agreement, or transferable interest.¹¹⁴

The Section 3(c)(1) exemption from characterization as an investment company under the ICA excludes small private investment vehicles whose “outstanding securities . . . are beneficially owned by not more than one hundred persons” and that do not make public offerings of its securi-

111. *Id.* at § 402 (to be codified at 15 U.S.C. § 80b-2).

112. 15 U.S.C.A. § 80a-3(a)(1) (West 2011).

113. *Id.* § 80a-2(a)(22).

114. *Id.* § 80a-2(a)(36).

ties.¹¹⁵ The 3(c)(7) exemption allows an unlimited number of investors as long as all meet the higher standard of being “qualified purchasers.”¹¹⁶

Investment vehicles such as family office pooled investment vehicles may fall within this definition of investment company and be subject to registration with the SEC as investment companies unless an exemption is available.¹¹⁷ Family office pooled investment vehicles usually can operate without registration under the ICA based on compliance with the Section 3(c)(1) or Section 3(c)(7) exclusions described above.¹¹⁸ Investment vehicles meeting the definition of investment company and falling within one of these exclusions will also be considered a private fund under the Dodd-Frank Act definition and investment advisers to these entities may be eligible for the Private Fund Adviser exemption if the investment adviser (i) does not advise any entities other than private funds and (ii) has assets under management of less than \$150 million managed in the United States.¹¹⁹

Non-US Advisers and the Newly Created Foreign Private Fund Adviser Exemption

The IAA prohibits “investment advisers” from utilizing any means or instrumentality of interstate commerce in connection with the business of investment advising unless the adviser registers with the SEC or an exemption applies.¹²⁰ An “investment adviser” is “any person who, for compensation, provides advice to others about the advisability of investing in, purchasing, or selling securities.”¹²¹ A “person” is “any natural person or company.”¹²² “Interstate com-

115. *Id.* § 80a-3(c)(1).

116. *Id.* § 80a-3(c)(7).

117. Talley, *supra* note 25, at 287.

118. *Id.*

119. The SEC has issued final regulations regarding how the assets under management will be calculated. Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less than \$150 Million in Assets Under Management, and Foreign Private Advisers, 76 Fed. Reg. 39,646, 39,668-72 (July 6, 2011) (to be codified at 17 C.F.R. pt. 275). Advisers must calculate the value of all assets of private funds managed by the adviser to determine if the value is below the \$150 million limit. *Id.*; see Private Fund Adviser Exemption, 17 C.F.R. § 275.203(m)-1(d)(2011). This amount must be calculated on an annual basis and reported in the adviser’s annual updating amendments to its Form ADV. § 275.203(m)-1(c); Amendments to Form ADV, 17 C.F.R. § 275.204-4(a) (2011). All assets managed by an adviser are managed “in the United States” if the adviser’s principal office and place of business are in the United States, regardless of whether the adviser has foreign offices. *Id.* § 275.203(m)-1(d)(7).

120. 15 U.S.C.A. § 80b-3(a).

121. *Id.* § 80b-2(a)(11).

122. *Id.* § 80b-2(a)(16).

merce” includes trade, commerce, transportation or communication between a foreign country and a state.¹²³ Thus, the plain language of the IAA appears to apply its terms, including registration requirements, to foreign investment advisers that provide services to U.S. clients, subject to the threshold requirement that foreign investment advisers make sufficient use of the means and instrumentalities of interstate commerce to justify the exercise of SEC jurisdiction.¹²⁴

The SEC once required foreign advisers to register under the IAA on an entity-by-entity basis.¹²⁵ If a foreign adviser registered with the SEC because of its business with U.S. clients, all of the adviser’s activities became subject to SEC regulation, regardless of where the activity occurred.¹²⁶ This broad interpretation severely restricted the ability of foreign advisers to engage in conduct that would be legal under foreign laws and led to the widespread practice of foreign advisers establishing strictly regulated subsidiaries to carry out business in the United States.¹²⁷ Intense criticism of the old approach resulted in the SEC Division of Investment Management recommending that the SEC adopt a narrower conduct and effects test in 1992.¹²⁸ The proposed test would require a foreign adviser to register if a sizeable amount of advisory services took place in the United States or the advisory services had effects in the United States.¹²⁹ The Division illustrated the application of the proposed rule with four hypothetical examples:

[W]here a registered foreign adviser or a registered domestic adviser deals with clients resident in the United States, it can be assumed that a sizable amount of advisory services will take place in the

123. *Id.* § 80b-2(a)(10).

124. *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less than \$150 Million in Assets Under Management, and Foreign Private Advisers, 76 Fed. Reg. at 39,674 n.415.

125. SEC. & EXCHANGE COMM’N, DIV. OF INV. MGMT., PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION 221 (1992), *available at* <http://www.sec.gov/divisions/investment/guidance/icreg50-92.pdf>.

126. *Id.*

127. *Id.*

128. *Id.* at 221–22.

129. *Id.* at 222.

United States and that there will be effects in the United States and the Advisers Act will apply. Where, however, a registered foreign adviser deals with a client residing outside the United States, the Advisers Act generally will not apply. A more difficult question arises where a registered domestic adviser deals with a client residing outside the United States. In such a case, a sizable amount of advisory services is likely to take place in the United States and the Advisers Act ordinarily will apply. Another difficult question arises where either a foreign or a domestic adviser is multinational, that is, has offices outside its foreign or domestic base. Here again, application of the Advisers Act will depend on whether a sizable amount of advisory services takes place in the United States. Thus, for instance, if a domestic adviser has a branch office in a foreign country, and has a corporate policy requiring that all portfolio decisions regarding clients residing in that country come from that foreign office, then the Advisers Act generally would not apply. If, on the other hand, the client wishes to invest in United States markets and the firm's personnel located in the United States are involved in formulating or providing advice, the Advisers Act generally would apply! Because of the fact-specific nature of these issues, close cases would be addressed on a case-by-case approach through interpretive and no-action letters.¹³⁰

130. *Id.*

SEC staff adopted the conduct and effects test in a 1992 No-Action Letter granted to Uniao de Bancos de Brasileiros S.A (Unibanco).¹³¹ Unibanco was a Brazilian banking organization that provided investment management services to foreign clients. Its wholly owned subsidiary, Unibanco Consultoria de Investimentos S/C Ltda. (UC), provided investment services to U.S. clients. Unibanco sought assurance that the SEC would not require Unibanco to register under the IAA despite UC's activities in the United States. SEC staff noted the Commission's prior position that all provisions of the IAA govern relationships between registered foreign investment advisers and their clients, regardless of whether the clients reside in the United States or not.¹³² The SEC staff acknowledged the problems with that interpretation, including the difficulties of operating a separate and independent subsidiary to provide advice to U.S. clients.¹³³ In light of these problems, the SEC adopted the conduct and effects test proposed by the Division of Investment Management's 1992 report. Since Unibanco did not provide investment services to U.S. clients, the SEC would not recommend enforcement action if Unibanco did not register under the IAA, notwithstanding the fact that Unibanco's wholly owned subsidiary, UC, provided services to U.S. clients and UC's board of directors was composed entirely of Unibanco's investment committee.¹³⁴ Subsequent No-Action Letters have adhered to the Unibanco conduct and effects test.¹³⁵

The Dodd-Frank Act created a new registration exemption for any investment adviser that is a "foreign private adviser."¹³⁶ The Act defines a "foreign private adviser" as an adviser who (1) lacks a place of business in

131. Uniao de Bancos de Brasileiros S.A., SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 76, 425 (July 28, 1992).

132. *Id.* (citing Reavis & McGrath, SEC No-Action Letter, 1986 SEC No-Act. LEXIS 2868 (Oct. 29, 1986)).

133. Uniao de Bancos, *supra* note 130 (citing Investment Advisors Act Rel. No. 353, 1972 WL 128952 (Dec. 18, 1972) (proposing five requirements for a subsidiary to be considered a separate, independent entity)).

134. *Id.*

135. *See, e.g.*, AIMA, Co. ABA Subcomm. On Priv. Inv. Entities, SEC No-Action Letter, 2005 WL 3334980 (Dec. 8, 2005); Royal Bank of Can., SEC No-Action Letter, 1998 WL 289384 (June 3, 1998); ABN AMRO Bank, N.V., SEC No-Action Letter, 1997 WL 1038179 (July 1, 1997).

136. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 403, 124 Stat. 1376, 1571 (2010) (to be codified at 15 U.S.C. § 80b-3) (amending 15 U.S.C. § 80b-3(b)(3) by removing the private adviser exemption and replacing it with an exemption for foreign private advisers).

the United States, (2) advises private funds with fewer than fifteen clients or investors in the United States, (3) manages funds with assets attributable to U.S. clients and investors worth less than \$25,000,000 (or a higher amount as determined by the SEC by rule), (4) does not hold itself forth to the US public as an investment adviser, (5) does not advise any company that must register under the Investment Company Act of 1940, and (6) does not act as a business development company pursuant to the Investment Company Act of 1940, and has not withdrawn its election.¹³⁷

The SEC has adopted final rules clarifying the definitions of terms relevant to the foreign private fund adviser exemption. Advisers may treat an assortment of minor children, relatives, spouses, accounts, and trusts associated with a natural person as a single client.¹³⁸ An investor may also treat the following as a single client: a corporation, general partnership, limited partnership, limited liability company, trust, other legal organization, or two or more legal organizations that have identical shareholders, partners, limited partners, members, or beneficiaries.¹³⁹ The final regulations define the phrase “in the United States” by reference to Regulation S.¹⁴⁰

The enactment of the Dodd-Frank Act raised questions regarding the continuing applicability of the principles expressed in the Unibanco line of No-Action Letters to offshore affiliates of registered advisers.¹⁴¹ The letters were issued in the context of the private adviser exemption, which the Dodd Frank Act eliminated.¹⁴² In issuing its final rule regarding IAA registration exemptions for foreign private advisers, the SEC stated that while it was not withdrawing any of the rules provided by the Unibanco line of letters, it expected SEC staff to provide “appropriate” guidance as to the application of those letters to the new foreign private adviser exemption and the private fund adviser exception.¹⁴³ Accordingly, while the Unibanco conduct and effects test continues to apply, one must be careful about applying such principles to investment advisers seeking to take advantage of the foreign private adviser or private fund adviser exemptions. It may

137. *Id.* § 402 (amending 15 U.S.C. § 80b-2(a)(30)).

138. 17 C.F.R. § 275.202(a)(30)-1(a)(1) (2011).

139. *Id.* § 275.202(a)(30)-1(a)(2).

140. *Id.* § 275.202(a)(30)-1(c)(3) (citing *id.* §§ 230.902(l), 230.902(k)).

141. JORDON ET AL., *supra* note 6, § 6:29.

142. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 403, 124 Stat. 1376, 1571 (2010) (to be codified at 15 U.S.C. § 80b-3).

143. Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less than \$150 Million in Assets under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222, 2011 WL 2482894 at *51 (June 22, 2011).

be advisable for such advisers to obtain no-action letters from the SEC.

STATE REGULATION

Investment advisers, including trustees, with less than \$100 million in assets under management¹⁴⁴ may be subject to state registration requirements rather than those of the IAA. The Dodd-Frank Act raises the SEC registration threshold to \$100 million, which means that investment advisers with less than \$100 million in assets under management will generally be required to register with the applicable states rather than the SEC.¹⁴⁵ However, there are many circumstances under which this rule does not apply. Investment advisers with less than \$25 million in assets under management are required to register with the SEC if they (i) are not subject to state registration in the state of the investment adviser's principal place of business; or (ii) are an adviser to an investment company registered under the ICA.¹⁴⁶ Investment advisers with between \$25 million and \$100 million in assets under management are required to register with the SEC if they (i) are not subject to state registration in the state of the investment adviser's principal place of business; (ii) would otherwise be required to register in fifteen or more states; or (iii) are an adviser to an investment company registered under the ICA or a business development company pursuant to section 54 of the ICA.¹⁴⁷ The following table summarizes the requirements of the assets under management threshold.

Assets Under Management	Must Register with the SEC
Less than \$25,000,000	<ul style="list-style-type: none"> • Investment Advisers not subject to state registration requirements • Investment Advisers who advise one or more investment companies

144. The term "assets under management" is defined as "the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services." 15 U.S.C.A. § 80b-3a(a)(2) (West 2011).

145. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 410, 124 Stat. 1376, 1576-77 (2010) (to be codified at 15 U.S.C. § 80b-3).

146. 15 U.S.C.A. § 80b-3a(a)(1)(West 2011).

147. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 410, 124 Stat. 1376, 1576-77 (2010) (to be codified at 15 U.S.C. § 80b-3).

Between \$25,000,000 and \$100,000,000	<ul style="list-style-type: none"> • Investment Advisers not subject to state registration requirements • Investment Advisers who would otherwise be required to register in 15 or more states • Investment Advisers who advise one or more investment companies or business development companies
Over \$100,000,000	All

This exemption is unavailable to certain investment advisers because that are not subject to state registration requirements, such as the state of Wyoming.¹⁴⁸ Therefore, private trust companies, trustees and other entities acting as investment advisers in such states will be required to register under the IAA unless another exemption is available.

ADDITIONAL QUESTIONS

Could a Manager of a Limited Liability Company (LLC), a General Partner of a Limited Partnership (LP) or a Director of a Corporation Be Considered an Investment Adviser?

Any entity or individual can be considered an investment adviser if he or she meets the requirements of the definition as described in more detail above. The IAA definition of investment adviser includes any person who (1) provides advice regarding securities; (2) is in the business of providing such services; and (3) receives compensation for such services.¹⁴⁹ Compensation for the advisory services can be included in overall compensation for a variety of other services. Thus, managers of LLCs, general partners of LPs and directors of corporations are not excluded from the definition and an analysis must be done to determine whether a particular individual or entity falls within the definition.

It appears clear that if the manager of an LLC or general partner of an LP provides investment management services as a part of his or its duties as manager/limited partner, such person would likely still be considered an investment adviser and would need to register or fall within one of the exemptions from registration detailed above. While no SEC interpretations directly address this issue, previous rules issued under the IAA provide that

148. See Reimer, *supra* note 9, at 187–90.

149. 15 U.S.C.A. § 80b-2(a)(11)(West 2011).

the manager of an LLC or general partner of an LP can be considered an investment adviser of that entity. For purposes of the private adviser exemption, the SEC provided a safe harbor rule identifying the persons and entities deemed a single “client” for purposes of counting and maintaining fewer than fifteen clients.¹⁵⁰ The rule provides that “a limited partnership or limited liability company is a client of any general partner, managing member or other person acting as investment adviser to the partnership or limited liability company.”¹⁵¹ Rules proposed by the SEC on December 10, 2010 indicate that because Congress has eliminated the private adviser exemption, the SEC intends to rescind this rule.¹⁵² However, by counting an LLC or LP as a “client” of the manager of that LLC or general partner of that LP, the SEC has clearly indicated that the manager of an LLC and the general partner of an LP will be considered an investment adviser where that manager or general partner is acting as an investment adviser.

However, it is not as clear that the investment adviser definition would be applied to a director of a corporation. This is because there is no corresponding rule regarding directors of a corporation and no other SEC interpretations appear to directly address the issue. It remains uncertain that the SEC would consider a director of a corporation an investment adviser, but it is likely that a director, just as any other entity or individual, is not exempt from such a finding based simply on his or her role as a director rather than an outside adviser to the corporation.

Options for Avoiding Registration

Affiliating with or Appointing a Registered/Exempt Co-Trustee

As discussed above, the SEC has stated that “a person who, for compensation, engages in the business of investment management *with the discretionary power to buy and sell securities* is an investment adviser even if such business is operated through the medium of trusts.”¹⁵³ In further de-

150. 17 C.F.R. § 275.203(b)(3)-1 (2011).

151. *Id.* § 203(b)(3)-1(b)(3).

152. Rules Implementing Amendments to the Investment Advisers Act of 1940, 75 Fed. Reg. 77,052, 77,073 (proposed Dec. 10, 2010) (to be codified at 17 C.F.R. pt. 275 and 279). However, the proposed rules regarding exemptions for advisers to venture capital funds, private fund advisers with less than \$150 million in assets under management, and foreign private advisers indicate the SEC’s intention to include the safe harbor for counting clients in the new proposed rule regarding the foreign private adviser exemption. Exemptions Advisers to Venture Capital Funds, Private Fund Advisers with Less than \$150 Million in Assets Under Management, and Foreign Private Advisers, 75 Fed. Reg. 77,190, 77,210 (proposed Dec. 10, 2010) (to be codified at 17 C.F.R. pt. 275).

153. Nameth, *supra* note 5, at *1 (emphasis added).

fining the term “investment adviser” and its application to trustees, the SEC has stated that “we would consider a trustee’s having the discretionary management power to make purchases and sales for the benefit of its fiduciary accounts as indicating that it acts as an investment adviser.”¹⁵⁴ In explaining that another trustee would be required to register as an investment adviser, the SEC relied on the determination that “in exercising discretionary authority, [the trustee] is providing advisory services to the trusts.”¹⁵⁵ Based on these determinations, although never specifically excluded from the definition by the SEC, it is likely that a trustee who lacks discretionary authority to buy and sell the securities held by the advised trusts would not be considered an investment adviser under the IAA and would not be required to register. Therefore, if a trustee, who might otherwise fall within the definition of an investment adviser, transfers (by delegation or contract) all discretionary authority over investment decisions to an appointed co-trustee, the original trustee could perhaps not meet the definition of investment adviser under the IAA. Such a trustee would not be required to register under the IAA and would not need to seek an exemption from registration. It remains uncertain that the SEC would find such trustees who lack discretionary power over investments to not be investment advisers, but the SEC’s past interpretations of the definition indicate that it might.

Many states have abrogated the common law non-delegation doctrine¹⁵⁶ and now authorize trustees to delegate discretionary powers.¹⁵⁷ For example, Wyoming law authorizes a Wyoming trustee to delegate discretionary powers. Pursuant to Wyoming Statutes Annotated Section 4-10-909, a trustee “may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances.”¹⁵⁸ In connection with such delegation, the trustee must exercise

[R]easonable care, skill and caution in (i) selecting an agent; (ii) establishing the

154. R.C.A. Syvert, SEC No-Action Letter, 1980 WL 17479 (Aug. 18, 1980).

155. Philip Eiseman, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 80,914 (July 22, 1976).

156. See RESTATEMENT (SECOND) OF TRUSTS § 171 (1959) (“The trustee is under a duty to the beneficiary *not to delegate to others* the doing of acts which the trustee can reasonably be required personally to perform.”) (emphasis added); see also *id.* §§ 171 cmts. c (prohibiting delegation of the entire administration of a trust unless authorized by the terms of the trust instrument), h (prohibiting delegation of the power to invest trust assets).

157. UNIF. TRUST CODE § 807 & cmt. (2000); UNIF. PRUDENT INVESTOR ACT § 9(a) (1995); RESTATEMENT (THIRD) OF TRUSTS (PRUDENT INVESTOR RULE) § 171 (1992). See generally John H. Langbein, *Reversing the Nondelegation Rule of Trust-Investment Law*, 59 Missouri L. Rev. 105 (1994).

158. WYO. STAT. ANN. § 4-10-909(a) (West 2011).

scope and terms of the delegation, consistent with the purposes and terms of the trust; and (iii) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.¹⁵⁹

Therefore, it appears that Wyoming law would permit a trustee to delegate discretionary authority over investments to an agent such as a chartered trust company so long as reasonable care is exercised. Under these circumstances, it may be that the SEC would not consider a trustee to be an investment adviser under the IAA and the chartered trust company would also be excepted from the definition of investment adviser if it were regulated by the laws of a state. This determination would be dependent on the original trustee delegating discretionary power to a chartered trust company or other agent who would exclusively have all discretionary authority over the investments held by the trusts.

Modify the Underlying Trust

Based on the discussion above, it may be advisable to modify the language of a trust to require that any discretionary investment decisions be made by a trustee exempt from registration requirements under the IAA. Wyoming law appears to permit inclusion of such a provision in Wyoming trusts. Wyoming Statutes Annotated Section 4-10-105 provides that the terms of a trust shall prevail over any default provisions of the Wyoming Uniform Trust Code except for those expressly listed.¹⁶⁰ The provisions of the Act specified in the list do not include or relate to the discretionary investment authority of the trustee.¹⁶¹ Therefore, it appears permissible to include a provision in a Wyoming trust that prohibits a trustee subject to the registration requirements of the IAA from exercising discretionary authority over the trust investments.

Directed Trusts

It is possible to remove the trustee's discretionary power to buy and sell securities without modification or delegation under state law. For example, the Wyoming Uniform Trust Code contemplates a beneficiary's power to create 'Directed Trusts.'¹⁶² The relevant statute provides that

159. *Id.*

160. *Id.* § 4-10-105(b).

161. *See id.*

162. *Id.* § 4-10-718.

“[u]nless expressly prohibited by the trust instrument, the qualified beneficiaries of a trust may unanimously agree to designate a trust advisor with the power to direct the fiduciary’s investment decisions.¹⁶³ The term “investment decision” means with respect to any property, the “retention, purchase, sale, exchange, tender or other transaction affecting the ownership thereof or rights therein.”¹⁶⁴ Thus, the beneficiaries alone, with no action on the part of the trustee may effectively remove the trustee’s discretionary power to buy and sell securities. It seems that if a fiduciary were so “directed,” it should not be subject to registration requirements of the IAA because it legally has no authority to make discretionary investment decisions.

Trustees in fact often are favorable to becoming “directed.” Under Wyoming law, if the written designation of a separate trust advisor is furnished to the trustee and the trustee acts in accordance with the direction from the designated trust advisor, the trustee is treated as an “excluded fiduciary” under Wyoming law.¹⁶⁵ The Wyoming Uniform Trust Code provides:

Unless the trust instrument appointing, designating or providing for a method for appointing a trust protector or trust advisor or the court order appointing a trust protector states otherwise, an excluded fiduciary is relieved of any duty or responsibility to review the actions of a duly named and appointed trust protector or trust advisor.¹⁶⁶

The Code further provides:

Unless the trust instrument appointing, designating or providing for a method for appointing a trust protector or trust advisor or the court order appointing a trust protector states otherwise, the excluded fiduciary is not liable for any loss resulting from any action or inaction of the trust advisor or protector.¹⁶⁷

Trusts may also be “deemed directed” if the document provides that a trust protector, advisor, or any person has the ability to control investment

163. WYO. STAT. ANN. § 4-10-718(e) (West 2011).

164. *Id.* § 4-10-718(f).

165. *Id.*

166. *Id.* § 4-10-715.

167. *Id.* § 4-10-717.

decisions.¹⁶⁸ Therefore, current trusts may be drafted in such a way that the trustee is exempt from regulation, and the practitioner should seek to determine if any action is needed to comply with IAA at all in such event.

In all events, the separately appointed trust advisor would presumably be registered investment advisor, or perhaps a state chartered trust company exempt from such regulation.

Issues Specific to Private Trust Companies

Private trust companies have become extremely popular in recent years.¹⁶⁹ Depending on the terms of trust underlying a particular private trust company, practitioners have historically shied away from allowing beneficiaries or their families to directly own or control the private trust company for fear of adverse estate, gift, or generation-skipping transfer (GST) tax consequences.¹⁷⁰ This tendency has softened a bit since the IRS issuance of Notice 2008-63.¹⁷¹ The Notice describes situations in which the appointment of a private trust company to act as trustee of a family trust alone will not: (1) cause the value of the trust's assets to be included in the grantor's gross estate; (2) cause the value of the trust's assets to be included in the beneficiaries' gross estates; (3) trigger incomplete gift treatment if the private trust company has discretion to distribute income or principal to the grantor's children or descendants, (4) affect a trust's GST tax exempt status or change a trust's inclusion ratio; or (5) trigger grantor treatment of the trust.¹⁷² However, such notice is not final guidance and may be revised prior to the adoption of a final revenue rule.¹⁷³ Additionally, the proposed rule may contain ambiguities that could interfere with attempts to utilize private trust companies as trustees of family trusts without triggering adverse tax consequences.¹⁷⁴

168. *Id.* § 4-10-718(a), (b), (c).

169. See generally Ytterberg & Weller, *supra* note 9; Iris J. Goodwin, *How the Rich Stay Rich: Using a Family Trust Company to Secure a Family Fortune*, 40 SETON HALL L. REV. 467 (2010).

170. Ytterberg & Weller, *supra* note 9, at 476 n.42; George R. Galloway, *Private Trust Companies: An Informal Primer*, 19 OHIO PROB. L.J. 233 (2009); Carleen L. Schreder, *The IRS Issues Guidance on Private Trust Companies*, 36 EST. PLAN. 8, 10 (2009); see also I.R.C. §§ 2036 (imposing estate tax based on certain retained life estates), 2038 (imposing estate tax based on certain revocable transfers), 2041 (imposing estate tax based on certain powers of appointment), 2511 (imposing gift tax on certain transfers to trusts), 2601 (imposing GST tax), 671–678 (providing rules for grantor trust treatment of certain trusts).

171. I.R.S. Notice 2008-31 I.R.B. 261 (July 11, 2008).

172. *Id.*

173. *Id.*

174. See Schreder, *supra* note 170, at *10-11.

However, with the passage of the Dodd-Frank Act, all private trust companies could now be subject to regulation unless they can meet a specific exemption. In certain states, private trust companies are not regulated, and as such will not meet the chartered trust company exemption. In such case, the obvious alternative for exemption would be to meet the new “family office” exemption.

As mentioned above, to qualify for the exclusion from registration under the IAA, a private trust company wishing to qualify as a family office must be wholly owned by family clients (“Ownership Test”) and exclusively controlled, either directly or indirectly, by family members or family entities (“Control Test”).¹⁷⁵ The term family entity is defined to include any of the trusts, estates, companies and other entities included in the definition of family client.¹⁷⁶ In the case of a trust that is a family client, all current beneficiaries must be family members (if irrevocable) or a family member must be the grantor (if revocable).¹⁷⁷ While any family client, including key employees, may hold an ownership interest in the private trust company, control of the private trust company must be maintained solely by family members and family entities (*i.e.*, their wholly owned companies or family trusts).¹⁷⁸ Control is defined 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.”¹⁷⁹

Both the ownership and control tests can be met by having the family members, or trusts for their benefit as shareholders of the private trust company. Depending on the terms of the underlying trusts, special care must be taken to avoid adverse gift, estate, or GST tax consequences.¹⁸⁰

CONCLUSION

The full effect of the 2007 financial crisis may not reveal itself for some time. But for the near future, the Dodd-Frank Act will remain an onerous reality for many professionals involved in the management and investment of client wealth. Many trustees of private trusts that once avoided registration as investment advisers with the SEC may now be forced into a new regulatory scheme. Fiduciaries that once relied on the private adviser exception must now register with the SEC or find a new

175. 17 C.F.R. § 275.202(a)(11)(G)-1(b)(2) (2011).

176. *Id.* § 275.202(a)(11)(G)-1(d)(5).

177. *Id.* § 275.202(a)(11)(G)-1(d)(4)(vi), (vii).

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

179. *Id.* § 275.202(a)(11)(G)-1(d)(2).

180. *See* sources cited *supra* note 170.

exception. A number of private trustees should be able to fit into the new regulatory exception for family offices by (1) providing advice about securities only to certain family clients, (2) ensuring that the family office is wholly owned by family clients and is wholly controlled by family members or family entities, and (3) not holding themselves forth to the public as investment advisers.¹⁸¹ Additionally, many investment advisers that previously obtained exemption from SEC regulation may be grandfathered and not required to register. Regardless, trustees and other fiduciaries that provide advice to clients regarding securities need to reassess their status to ensure compliance with the Dodd-Frank Act.

181. 17 C.F.R. § 275.202(a)(11)(G)-1(b)(2011).