

[Blogs](#)

September 17, 2015

Can a Family Office Client Ever Cease to be a "Client;" Can a Non-Family Third Party Ever Become a "Client" of a Family Office?

The [Family Office Rule](#) states that a family office cannot have any clients other than family clients. The term "family client" is defined in paragraph (d)(4) of the Family Office Rule to include any family member, any key employee, certain non-profit organizations, certain irrevocable and revocable trusts, and certain wholly-owned companies, all as set forth in subparagraphs (i), (iii), (v), and (vii) - (xi) of that paragraph. It was intended that a person who was a "family client" would never cease to be a client of the family office except under unusual circumstances. To that end, there are exceptions in subparagraphs (ii), (iv), and (vi) of that paragraph for former family members, for former key employees, and for the estates of family members, former family members, and former key employees. On the other hand, it was also anticipated that a person who was a non-family client might become a client of the family office as a result of death or another involuntary event. This could occur, for example, if a non-family charitable entity was the ultimate contingent beneficiary pursuant to a family member's will and, after that family member's death, all other dispositions failed for some reason. Under those circumstances, the non-family charity would get the benefit of the family office's services during the probating of the estate and until the assets were distributed to it, but one could quite reasonably argue that, given the exception for estates of family members, the estate should be treated as the "client" (not the non-family charitable entity) until the process of probating had concluded. Interestingly, the proviso in paragraph (b)(1) of the Family Office Rule provides that such a non-family person shall be deemed to be a family client for purposes of that paragraph for one year following the completion of the transfer of legal title to the assets resulting from the involuntary event. All things considered, this is a sensible outcome: the family office could not prevent the involuntary event; and the non-family charitable entity could not precipitate the event that caused it to benefit from the services of the family office; so neither of those events should be the proximate cause of the family office having to register with the SEC as an investment adviser solely because a non-family entity has benefited indirectly from its services for a transitory period of time. While this proviso might be thought to be unnecessary in light of the exception for estates, it does seem to provide extra protection to the family office. Moreover, there is a potential scenario where the proviso would be applicable. What if the family member makes clear his intention through his will (or some other kind of binding written instruction to his executor or members of his family) that certain assets managed by the family office not captured in his estate be transferred to a third party. While the estate of the family member is treated as a "family client," assets that pass outside of the estate would not be covered by that exception. However, one would think that the proviso in paragraph (b)(1) should still apply. The event is still involuntary to the family member, and it is still involuntary to the third party who will become the owner of the asset. Additionally, the proviso in paragraph (b)(1) will deem the third party to be a family client for up to one year following the completion of the transfer of legal title to the assets caused by the involuntary event. Note again that the grace period begins with the completion of the transfer of legal title, not from the moment of death or the completion of the probate process. So even if the documentation and effectuation of the transfer outside the estate takes some time after the death of the family member, the family office itself would still be protected from losing its exemption from registration under the Investment Advisers Act. All things considered, that, too, seems like a sensible outcome.

Explore more in

[Investment Management](#)