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S.E.C. REGISTRATION OF FAMILY OFFICES: PRIVATE TRUST COMPANIES MAY PROVIDE ONE AVENUE OF RELIEF

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As the compliance deadline for registration with the United States Securities and Exchange Commission ("SEC") by family offices quickly approaches, the focus has shifted to alternatives to avoid registration rather than on submitting to registration and the concomitant compliance requirements. According to the 2011 research study by the Family Wealth Alliance ("FWA"), 54.5% of Single Family Offices ("SFOs") lack clarity regarding the potential impact of the Dodd-Frank Act and the new rules.

A TICKING CLOCK

At the FWA Fall Forum, family office industry experts estimated that as many as 80% of all SFOs have not yet addressed their obligations or exemption under the new rules. This lack of attention may prove problematic for those who do not squarely fall within the SFO exception. Generally, family offices are required to comply with the new law on or

before March 30, 2012. That date, however, is somewhat misleading since the SEC has estimated that it will take at least 45 days to process registrations, which would require a submission on or before February 15, 2012. Moreover, as the SEC gets flooded with new registrations and exemption ruling requests, it is highly foreseeable that the processing time will be extended, requiring even earlier submissions. Consequently, SFOs and their counsel should immediately assess their level of compliance with the new rules, thus providing time to register, seek an exemption order, or restructure to avoid SEC registration.

SFO CONCERNS

Private families and their advisors share some significant concerns despite the improvements made to the rules following the comment period. Many of these concerns stem from the relatively unrestrained power of the SEC coupled with onerous on-going requirements for Registered Investment Advisors ("RIAs"). These requirements include submission and updating of filing obligations for the RIA entity (Form ADV) and for each investment advisor (Form U-4). These filings are maintained in the investment advisor registration depository managed by the Financial Industry Regulatory Authority. The licensing period is annual and carries with it record keeping, custody disclosures, audits and possible fiduciary duty requirements. These requirements in turn, highlight additional concerns relating to invasion of privacy and complete lack of confidentiality.

ACTION ITEMS

Family Offices should immediately review their operations and structure in order to carefully assess their current status of compliance. This is also an excellent opportunity to consider broader structure issues relating to privacy, asset protection, income tax issues, benefits and employee compensation. Further, prophylactic steps designed to deal with tax authorities and deal with the newly operational IRS Wealth Squad should be considered.

If the assessment concludes that the SFO is exempt, procedures should be established to document compliance now and on an on-going basis in order to prove the exemption and avoid inadvertent mistakes which would require registration. Similarly, compliance with state securities law requirements and other SEC rules should be reviewed and monitored. Where the assessment is inconclusive, SFOs should consider promptly seeking an exemption order.

Family Offices which are required to register have several alternatives including: a) registration after creating a captive investment firm or spinning off an investment subsidiary in order to limit SEC scrutiny to that enterprise alone; b) outsourcing the investment function to a multi-family office ("MFO"), institutional trust company, or other independent RIA; c) moving (for global families) the investment function to their international SFO or, creating an international SFO to compliment the U.S. based SFO; or, d) forming a private trust company, captive insurance company or private family

bank. SFOs should be aware, however, that these approaches necessarily trade one set of government regulators for another.

PRIVATE TRUST COMPANIES

A trend that wealthy families are considering recently is the benefit offered by creating the family's own private trust company. If a family office restructures and implements a private trust company, they can avoid the Dodd-Frank compliance burden. Certainly, not all families with a family office will benefit from creating and maintaining a private trust company. Nevertheless, given the right set of circumstances, the addition of a private trust company can compliment the family office.

Because family needs differ, there is no specific level of wealth that determines when the need for a family office or a private trust company arises, but there are some general industry guidelines. Industry experts believe that the investable asset threshold is approximately $250 million for an SFO, and $20 million for an MFO.

While the MFO threshold is much lower, other factors are typically involved. A family will consider the services of an MFO when the family feels they no longer can manage (or no longer desire to manage) the family wealth from a complexity perspective, and the family generally believes there is enough accumulated wealth to outlast the controlling generation's lifetime.

For a family in need of a private trust company, many of the same attributes for a family office can be found, with the additional goal of more control over the trustee, and less concern for the cost of implementing and maintaining the private trust company. The family will seek to replace an existing corporate trustee with a captive, family-friendly trustee that will cater to the family's needs while satisfying the requirements of a corporate trustee.

WHY A PRIVATE TRUST COMPANY?

Wealthy families create private trust companies to act as the independent trustee for the family's trusts. A private trust company can be structured to meet the requirements of an independent fiduciary where the trustee *must* be a corporate trustee and the family desires to retain greater control over the administration of the trust. This is especially common where the trust agreement (perhaps an older agreement) calls for a corporate fiduciary, or the trustee succession has resulted in a successor corporate trustee. Note that a private trust company tends to be a captive entity, because it is owned and controlled by the family. For some families, this is the control feature they are looking for over a traditional corporate fiduciary relationship.

RETENTION OF SINGLE STOCK HOLDING

One area where control over the fiduciary decision-making function is critically important is the decision to diversify or not diversify a single stock position. Some

traditional corporate trustees may be hesitant to hold a single stock concentration at the request of the family. With a private trust company, however, the decision makers are those same family members who benefited from the investment concentration, or the advisors that those family members hire, and thus there is a motivation to continue with the family's long-term investment concentration philosophy. Therefore, in many situations, the single stock investment concentration is the driving force for the family to create the private trust company, which insures the investment concentration will be retained in each of the various family trusts.

EASE OF TRUSTEE SUCCESSION

Continuity of trusteeship is another reason families consider a private trust company. Long-term trusts established for multiple generations are common in affluent families. There are a number of issues that arise in the trust administration of long-term trusts for multi-generational families, not the least of which is trustee succession. One inherent problem arises when the long-term trust outlasts the designated individual trustees. While many sophisticated trust documents provide for trustee succession provisions, not all documents for a family will necessarily have similar succession provisions, and suitable successors may be difficult to identify. Thus, the controlled management of trustee succession can be problematic.

OPERATION OF THE TRUST COMPANY

The family's private trust company will be controlled by the family, but governed by specific corporate governance provisions of the company. A common arrangement would be to have a board of directors for the company that is comprised of a significant number of family members. That family controlled board can then hire outside advisors to handle day-to-day operations of the trust company. If a corporate fiduciary previously acted as the trustee and custodian over the family's trust assets, that corporate fiduciary may very likely be retained by the private trust company to serve in a custodial capacity, or perhaps in an administrative capacity. Thus, the family maintains fiduciary decision-making control, a potentially uncomfortable role for the corporate fiduciary, yet continues to act in a custodial capacity, a routine function for the corporate fiduciary.

CONCLUSION

As private families struggle to comply with the new SEC rules and avoid registration, private trust companies may provide one avenue of relief in addition to essential control and governance. However, there can be significant costs involved in creating and maintaining a private trust company governed by state banking laws.

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