



Truth Endures For All Generations And Perhaps So Can A Family Office

By Keith Paul Bishop on October 20, 2011

Many rich people establish “family offices” to provide investment advisory services to family members. Section 409 of the Dodd-Frank Act excludes “family offices” from the definition of “investment adviser” under the Investment Advisers Act of 1940. Congress left it up to the Securities and Exchange Commission to define who is and isn’t family for purposes of the family office exclusion.

SEC Defines “Family Members”

Under the SEC’s new rule, a “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 of those descendants, provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members. Rule 202(a)(11)(G)-1(b)(1). All children by adoption and current and former stepchildren also are considered family members.

Enduring For All Generations

Ten generations is a lot of generations. If the average generation is 25 years, then a common ancestor may have lived more than two centuries ago. The SEC’s definition also gives people a lot of choices. We all have two parents, four grandparents, eight grandparents and so on. This can be expressed as 2^n with $n =$ to the number of generations. An individual has 2^{10} , or 1,024 lineal ancestors at the 10th generation. However, the rule doesn’t require a family to choose only from its tenth generation ancestors. Thus, an individual can be identified from any of the ten generations. This means that the number of individuals in the pool of potential common ancestors is equal to $2^{10} + 2^9 + 2^8 . . . + 2^1$, or 2,046 people. Of course, there are consequences to which generation is chosen. Choosing someone farther up the generational tree will increase the number of collateral family members that can be served by the family office but will limit the number of future lineal descendants.

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Enduring Past 10 Generations

After ten generations, the family office does not have to die. The rule does not preclude a family from changing its common ancestor. In fact, in the [adopting release](#), the SEC gives this example:

For example, G1 (who is deceased) founded a business and placed his fortune into a trust for the benefit of his heirs. G4 founded a family office to manage that wealth for the ever growing number of family members descended from G1 and treated G1 as the common ancestor for purposes of which family members the family office could advise under the exclusion. At the time G4 created the family office, current clients extended as far as G4's great-grandchildren (or G7). Over time the family grows and additional generations are born. Eventually, to allow the family office to serve later generations that would otherwise extend beyond the 10 generation limit, the family office redesignates its common ancestor to an individual in G3.

Why Ten Generations?

The SEC adopted the ten generation limit in response to comments received. In support, the SEC cites other state and federal statutes that define family members by degree of lineal kinship. However, only one of these examples, Nevada Revised Statute § 669.042, employs a ten year limitation. Indeed, depending upon lifespan, birth rates, adoptions, and rates of marriage, the number of family members descended from a common ancestor 10 generations back could be in the thousands.

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