

The SEC Clarifies Status of Institutional Family Offices for Purposes of Regulation Best Interest

March 22, 2021

Background

Recently, staff of the Securities and Exchange Commission (SEC) issued a no-action letter stating that they would not regard “Institutional Family Offices” as retail customers of broker-dealers for purposes of broker-dealers’ obligations under Regulation Best Interest (Reg BI) and Form CRS.

In a no-action letter dated December 23, 2020, staff of the Division of Trading and Markets (the Division) of the SEC granted a request by the Securities Industry and Financial Markets Association (SIFMA) not to pursue enforcement action against broker-dealers “that do not treat family offices that qualify as ‘Institutional Family Offices’ as ‘retail customers’ for purposes of Regulation Best Interest,” or as “retail investors” for purposes of Form CRS requirements. Family offices are legal entities established by wealthy families to manage their investments and provide other services, such as tax and estate planning.

Generally, Reg BI imposes obligations that apply to broker-dealers when making a recommendation to a retail customer. Under Reg BI, broker-dealers and their associated persons must act in the best interests of the retail customer at the time the recommendation is made and must additionally meet four specific obligations: (1) disclosure; (2) care; (3) no conflict of interest; and (4) compliance.¹ Further, Form CRS requires SEC-registered investment advisers and SEC-registered broker-dealers to provide to retail investors a brief customer or client relationship summary that discloses information about the firm, including, among other things, “information about the relationships and services the firm offers to retail investors, fees and costs that retail investors will pay, specified conflicts of interest and standards of conduct, and disciplinary history.”²

Reg BI defines a “retail customer” as “a natural person, or the legal representative of such natural person who receives a recommendation of any transaction or investment strategy involving securities and uses the recommendation primarily for personal, family, or household purposes.”³ Form CRS similarly defines a “retail investor” as a “natural person, or the legal representative of such natural person, who seeks to receive or receives services primarily for personal, family, or household purposes.”⁴

Since the adoption of Reg BI by the SEC on June 5, 2019, there has been ambiguity concerning whether broker-dealers must treat family offices as “retail customers.”

¹ 84 Fed. Reg. 33318.

² 84 Fed. Reg. 33492

³ Exchange Act Rule 151-1(b)(1).

⁴ General Instruction 11(E) to Form CRS.

Among other things, in its request for no action relief, SIFMA offered a definition of a class of family offices called “Institutional Family Offices” and requested the SEC not to pursue enforcement action against broker-dealers that do not treat such family offices as “retail customers.” The Division granted the request for relief.

Highlights of the No-Action Letter

An Institutional Family Office, as proposed to be defined by SIFMA and accepted by the Division, is “a family office that has one or more experienced securities or financial services professionals, manages total assets of \$50 million or more, does not rely on the broker-dealer for recommendations, and has professionals who are independent representatives of their family clients.” The Division also accepted SIFMA’s proposal that the following specific characteristics must be present for a family office to be considered an Institutional Family Office by a broker-dealer:

- **One or More Experienced Securities or Financial Service Professionals.** To qualify as an Institutional Family Office, the family office must employ one or more persons who are experienced in the securities industry or investment related fields, and any professionals identified to satisfy this condition must not be subject to a “statutory disqualification” or sanctions.
- **Total Assets of \$50 million or More.** To qualify as an Institutional Family Office, the family office must manage total assets of \$50 million or more.
- **Independent of the Broker-Dealer.** To qualify as an Institutional Family Office, the family office must acknowledge that:
 - it is capable of evaluating investment risks independently, both in general and with regard to all transactions and investment strategies involving a security or securities;
 - it will exercise independent judgment in evaluating the recommendations of any broker-dealer or its associated persons;
 - it is a sophisticated investor with knowledge of an experience with regard to the securities or investment strategies involving a security or securities it trades or implements with the broker-dealer (if any);
 - the family office professionals responsible for investment decisions have not and will not accept any compensation or items of value from the broker-dealer that would cause the professional to act in a manner that is inconsistent with the best interest of the family clients; and
 - the family office meets the definition of “family office” under Advisers Act Rule 202(a)(11)(G)-1.
- **Supervision.** For an Institutional Family Office to fall outside the definition of a retail customer for purposes of Reg BI, the broker-dealer must establish policies and procedures that are reasonably designed to comply with the terms of the granted relief and maintain records demonstrating compliance with the terms of the relief.

The no-action relief issued by SEC staff applies solely to Institutional Family Offices and not family offices that do not meet the above definition. The no-action relief does not opine on investment advisers’ treatment of Institutional Family Offices. Further, this letter applies only to broker-dealers that do not treat Institutional Family Offices, as defined above, as retail customers or retail investors for the purposes of Reg BI and Form CRS, respectively.

See the [SEC No-Action Letter](#).

CONTACTS

For more information, contact your Katten attorney or either of the following attorneys in the [Financial Markets and Funds](#) practice.



Susan Light
+1.212.940.8599
susan.light@katten.com



Paul McCurdy
+1.212.940.6676
paul.mccurdy@katten.com

Katten

katten.com

CENTURY CITY | CHARLOTTE | CHICAGO | DALLAS | LONDON | LOS ANGELES | NEW YORK | ORANGE COUNTY | SHANGHAI | WASHINGTON, DC

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