

Title: Avoiding Regulation and Oversight?: A Halfway Decent DD on The 1940 Investment Act, Dodd-Frank and "Family Office" Fuckery

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****Introduction:**** What is a family office? Why would a hedge fund want to use the moniker when they are clearly anything but? What benefits and protections are offered under the aforementioned label, and of course, the crux of it all, what kind of epic fuckery comes as a result of banks and/or hedge funds using this uber-convenient term to avoid regulation and oversight? Finally, how is this all related to our favorite stonk???

If you've never bothered to ask these questions, well, you've probably been living in a rabbit hole—or a long series of them, in my case. But for a few months now, the "family office" exemptions have been gnawing away at my llama soul, tugging at the back of my ADHD stream of consciousness with the same insistence my three year old asks for another bar of chocolate.

Anywhoo, the other day, I came across a mention of 13F exemptions, and it came rushing back to me--that sick feeling I got when I learned that family offices don't have to file 13Fs and are granted the ability to move in stealth mode throughout the markets to some degree. Just how impactful ARE/WERE these family office exemptions, I wondered? The answer, I believe, is VERY. In fact, this is such prized information that it seems you actually have to PAY for a fucking database of family offices just to learn who has that status. Isn't that odd? Curiouser and curiouser, as Alice once said. But before we get into the nitty gritty, I want to take a minute to explain how and when the "family office" categorization came about.

****Section #1:** There are two VERY important pieces of information to ******understand before we embark upon this fucked up journey.******

Investment Advisers Act of 1940 (Investopedia breakdown):

******<https://www.investopedia.com/terms/i/investadvact.asp>******

TL;DR: This was put into place to prevent the kind of fuckery that led to prior economic and market-wide shitshows. With this Act in place, financial advisers needed to do their "fiduciary duty", put their clients first, fully disclose all "material facts"; and my favorite, register with a "regulatory body" such as the SEC! If you're thinking that banks and hedge funds didn't like that, you're right! They hated it. I bet you can see where this is going...but let's look a little deeper.

Investment Company Act of 1940 (Investopedia breakdown): <https://www.investopedia.com/terms/i/investmentcompanyact.asp>

TL;DR: This document essentially granted the SEC the ability to watch these fuckers and make sure they weren't engaging in gross negligence, market manipulation, and fucking their clients over. As Investopedia puts it: "The purpose of the Act was to protect investors at all costs". Uh oh. Protect investors? At the cost of profits for banks and hedgefunds. Do you smell a loophole coming? I certainly do, and it smells like shit.

****Section #2:** Okay, so where does the family office come in and what exactly constitutes a family office?******

Below is the definition of the family office for your consideration, but the gist of it is that essentially, in reality, ANY hedgefund or banking organization/lender can qualify for this status if they play their cards right (Remember that the definition of what constitutes "family" is intentionally opaque—which allows people like our friend Stevie Cohen to use and abuse that label after being "regulated"—think of it a little like an escape hatch—an escape hatch that has now become commonplace and dangerous in the wide

world of hedge fund fuckery.)

So, if you get the idea, skip down past the actual definition and the legislative bullshit to the next section:

****§ 275.202(a)(11)(G)-1 Family offices.****

(a) Exclusion. A family office, as defined in this section, shall not be considered to be an investment adviser for purpose of the Act.

(b) Family office. A family office is a company (including its directors, partners, members, managers, trustees, and employees acting within the scope of their position or employment) that:

(1) Has no clients other than family clients; provided that if a person that is not a family client becomes a client of the family office as a result of the death of a family member or key employee or other involuntary transfer from a family member or key employee, that person shall be deemed to be a family client for purposes of this section 275.202(a)(11)(G)-1 for one year following the completion of the transfer of legal title to the assets resulting from the involuntary event;

(2) Is wholly owned by family clients and is exclusively controlled (directly or indirectly) by one or more family members and/or family entities; and

(3) Does not hold itself out to the public as an investment adviser.

(c) Grandfathering. A family office as defined in paragraph (a) above shall not exclude any person, who was not registered or required to be registered under the Act on January 1, 2010, solely because such person provides investment advice to, and was engaged before January 1, 2010 in providing investment advice to:

(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 Act 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 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; provided that a family office that would not be a family office but for this subsection (c) shall be deemed to be an investment adviser for purposes of paragraphs (1), (2) and (4) of section 206 of the Act.

(d) Definitions. For purposes of this section:

(1) Affiliated Family Office means 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.

(2) Control means 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.

(3) Executive officer means the president, any vice president in charge of a principal business unit, division or function (such as administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions, for the family office.

(4) Family client means:

(i) Any family member;

(ii) Any former family member;

(iii) Any key employee;

(iv) Any former key employee, provided that upon the end of such individual's employment by the family office, the former key employee shall not receive investment advice from the family office (or invest additional assets with a family office-advised trust, foundation or entity) other than with respect to assets advised (directly or indirectly) by the family office immediately prior to the end of such individual's employment, except that a former key employee shall be permitted to receive investment advice from the family office with respect to additional investments that the former key employee was contractually obligated to make, and that relate to a family-office advised investment existing, in each case prior to the time the person became a former key employee.

(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, in each case 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 family member, former family member, key employee, or, subject to the condition contained in paragraph (d)(4)(iv) of this section, former key employee;

(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 company 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.

(5) Family entity means any of the trusts, estates, companies or other entities set forth in paragraphs (v), (vi), (vii), (viii), (ix), or (xi) of subsection (d)(4) of this section, but excluding key employees and their trusts from the definition of family client solely for purposes of this definition.

(6) Family member means all lineal descendants (including by adoption, stepchildren, foster children, and individuals that were a minor when another family member became a legal guardian of that individual) of a common ancestor (who may be living or deceased), and such lineal descendants' spouses or spousal equivalents; provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members.

(7) Former family member means a spouse, spousal equivalent, or stepchild that was a family member but is no longer a family member due to a divorce or other similar event.

(8) Key employee means any 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 with regard to the family office) who, in connection with his or her regular functions or duties, participates in the investment activities of the family office or affiliated family office, provided that such employee has been performing such functions and 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.

(9) Spousal equivalent means a cohabitant occupying a relationship generally equivalent to that of a spouse.

(e) Transition.

(1) Any company existing on July 21, 2011 that would qualify as a family office under this section but for it having as a client one or more non-profit organizations, charitable foundations, charitable trusts, or other charitable organizations that have received funding from one or more individuals or companies that are not family clients shall be deemed to be a family office under this section until December 31, 2013, provided that such non-profit or charitable organization(s) do not accept any additional funding from any non-family client after August 31, 2011 (other than funding received prior to December 31, 2013 and provided in fulfillment of any pledge made prior to August 31, 2011).

(2) Any company engaged in the business of providing investment advice, directly or indirectly, primarily to members of a single family on July 21, 2011, and that is not registered under the Act in reliance on section 203(b)(3) of this title on July 20, 2011, is exempt from registration as an investment adviser under this title until March 30, 2012, provided that the company:

(i) During the course of the preceding twelve months, has had fewer than fifteen clients; and

(ii) Neither holds itself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a), or a company which has elected to be a business development company pursuant to section 54 of that Act (15 U.S.C. 80a-54) and has not withdrawn its election.

****Section #3—Why the hell do I need to know any of this?****

<https://www.sec.gov/rules/final/2011/ia-3220.pdf>

Did you read it? If not, you should. If you're too lazy, tired, broken or stoned to do so, here's a quick TL;DR: This ruling makes it so that any entity that qualifies as a family office is basically exempted from a good deal of regulation and scrutiny, and the qualifications for being a family office are outlined in a fabulous chart at the very end which indicates essentially anyone who shares a shred of blue blood DNA with those ultra-elite families is guaranteed this protection. Hmmm, sounds shady, right? That's because it is. Now, benefit of the doubt, I do believe this was introduced in good faith to protect those truly smaller investment firms and banks, but like everything else it was exploited so that people like Steve Cohen and the rest could make clever use of the fabulous regulatory loopholes and avoid being held accountable for what happened in 2008, and to KEEP DOING THE SAME HORRIBLE SHIT! Awesome. Great. Wonderful.

But wait, there's more!

Let's leave 1940 and pull a Scott Bakula style Quantum Leap to 2008—when the shit really hit the fan—again. The hugely-important Dodd-Frank Act is introduced and it imposes strict regulations and requirements on all banks, lenders, hedge funds, you name it. These fuckers were essentially being put on lockdown. If you'd like to read the breakdown, here is the Investopedia link: <https://www.investopedia.com/terms/d/dodd-frank-financial-regulatory-reform-bill.asp>

So, The DFA prevented the “too big to fail” problem, prevented “systemic risks”, and introduced the Volcker Rule. What's that, you ask? Well, the Volcker Rule is “a federal regulation that generally prohibits banks from conducting certain investment activities with their own accounts and limits their dealings

with hedge funds and private [equity funds](<https://www.investopedia/>), also called covered funds.” The Volcker rule also prevents “speculative investments” that are super risky (shorts, anyone?). You can probably see where I am going with this.

The big money makers did NOT like any of this, as I’m sure you can imagine, and over the next ten plus years, they pushed for loopholes, loosening regulations and, as a result, there was a general unraveling of those restrictions—leading us to where we are today. In an economic vacuum sucking us all into oblivion while the ultra-wealthy are sitting pretty in another galaxy. A world where they can customize regulations, exemptions and legislation to suit their needs, where they can hide their money and their investment decisions from the only regulatory bodies standing in their way, and where they can fuck over every day people like you and me in order to multiply their fortunes and avoid paying any meaningful penalties.

Wait, so, why the focus on the family office? Here’s why. Let’s move on to the headlines.

****Section #4: Sound the alarms! It’s a fiscal free for all!****

There have been voices of concern (AOC brought it up as recently as yesterday!) over the family office exemptions and the regulatory “bowel loosening” that has resulted in the market potentially shitting the bed, but those voices have been silenced or largely gone unheard. Not that it’s much of a surprise considering how epically ignorant mankind has historically been regarding what’s truly good for them. Here are a few headlines and references worth checking out:

<https://www.swfinstitute.org/fund-rankings/family-office/> (scroll down to see the total assets! Definitely seems like “small family office” stuff, right?)

<https://canetwork.com/ultra-rich-prefer-multi-family-offices/> (smart to invest your money where nobody can see how you get more of it, huh?)

<https://www.bloomberg.com/news/articles/2021-04-01/archegos-shows-need-to-monitor-family-offices-berkovitz-says?srnd=premium&srref=ibr3A0ff> (Archegos was a family office...how convenient!)

<https://markets.businessinsider.com/news/stocks/archegos-credit-suisse-banks-senator-brown-collapse-committee-letter-2021-4> (in case you are out of Bloomberg articles)

<https://www.counterpunch.org/2021/05/24/family-offices-trillion-dollar-pools-of-unregulated-capital-you-havent-heard-about/>(unregulated capital is dangerous!!!!)

<https://www.questorg.com/2018/07/30/why-are-hedge-funds-converting-to-family-offices/> (look at the minimum requirements to start a family office--sounds counterintuitive, right?)

And my personal favorite: <https://www.telegraph.co.uk/luxury/design/jeffrey-epstein-worked-family-office-billionaire-advantage/>

There are so many more pieces I haven’t gotten to yet, and I fully anticipate a follow up DD as things develop, especially the conversation surrounding Archegos. For the time being, I hope this at the very least brought the issue of family offices to the forefront because it is definitely important.

****Conclusion****

I apologize in advance if this isn’t ultra-technical or wildly complicated, but the fact of the matter is, the fuckery is both complicated and not at all so. Family office exemptions, PFOF, stacked deck algorithmic HF trading—and so much more—are sucking us into an economic vortex, and it’s time to reverse the feed and actually make it stick. Please comment, offer corrections, or whatever, just be nice about it. Hope you learned something new, and happy Friday!

Cheers,

Llama