# Member Alert
# April 6, 2021

## Family Offices and Archegos

The rapid collapse of Archegos Capital Management last week was accompanied by calls for increased scrutiny of family offices. The Private Investor Coalition is responding to these concerns by educating policymakers and regulators regarding the underlying causes of the Archegos collapse, how it is unrelated to its status as a family office, and how pending regulations already address the gaps exposed by Archegos' aggressive trading strategies. Below are the four key points we will be making in the coming days.

**The Antithesis of a Family Office**: Family offices typically focus on wealth preservation and risk management by embracing a variety of investment strategies, including a strong emphasis on diversification and ensuring that no single investment can cause material harm.

The Archegos collapse, on the other hand, was the result of the fund adopting exactly the opposite investment philosophy -- it made highly concentrated and highly leveraged bets using Security-Based Swaps that were not fully visible to regulators nor Archegos' prime broker counterparties. As the Wall Street Journal reported:

> *Archegos took big, concentrated positions in companies and held some positions via something called "total return swaps." Those are contracts brokered by Wall Street banks that allow a user to take on the profits and losses of a portfolio of stocks or other assets in exchange for a fee.*
>
> *Swaps allow investors to take huge positions while posting limited funds up front, in essence borrowing from the bank. The use of swaps allowed Mr. Hwang to maintain his anonymity, even as Archegos was estimated to have had exposure to the economics of more than 10% of multiple companies' shares.*

Archegos utilized substantial leverage and numerous prime brokers to establish multi-billion-dollar positions in a handful of publicly traded stocks. When the value of those stocks dropped sharply, Archegos failed to make its margin calls and its prime brokers were left holding large underwater positions with little margin to cushion the blow.

That is exactly the opposite of the behavior one would expect from a family office.

**Family Offices are Regulated**:

Family offices must comply with the same margin requirements, trading restrictions, position limits and reporting requirements that apply to other market participants, including reporting requirements tied to investments in swaps and derivatives as well as those applying to investors who take large stakes in publicly traded securities.

Existing regulatory regimes that apply to family offices:

- Rule 13 – Public Securities: Existing regulations under Rule 13 require disclosure of large holdings or transactions of publicly traded securities. These rules apply to family offices just like any other investor:
  - Sections 13(d) & (g) – Investors owning 5 percent or more of publicly traded companies must file public disclosures of the applicable holding and disclose their activist intent, if any.
  - Section 13(f) – Investors having investment discretion over $100 million or more in publicly traded securities must file Form 13F disclosing all such positions to the SEC on a quarterly basis.
  - Section 13(h) – Large traders are required to identify themselves to the SEC by filing a Form 13H. A "large trader" is defined as a person, including a firm or individual, whose transactions in exchange-listed securities equal or exceed (i) two million shares or $20 million during any calendar day, or (ii) 20 million shares or $200 million during any calendar month. Registered broker-dealers are required to adopt procedures to monitor their customers for activity that would trigger the larger trader identification requirements and to report such activity to the SEC by the next day.
- Swaps/Derivatives: As with other market participants, family offices must obtain Legal Entity Identifier ("LEI") numbers which are designed to clearly identify all legal entities (including contact information) dealing in Over-the-Counter derivatives falling under CFTC jurisdiction.

**Investors Awaiting Critical New SEC Regulations**: When Congress passed the Dodd-Frank Wall Street Reform Act in 2009, it specifically charged the SEC and CFTC to develop new regulatory oversight mechanisms to address the risks inherent in Security-Based Swaps – the very trades highlighted by the Archegos collapse.

The SEC's final regulations on Security-Based Swaps are set to go into effect later this **year**. A summary of the new regulations prepared by the SEC can be accessed **here**. Had these regulations been in place earlier, they would have alerted the SEC to the emerging risks posed by Archegos, as they directly address the gaps in existing reporting requirements exposed by the Archegos trades. When they take effect later this year, these new regulations will apply to the Security-Based Swaps of family offices just like other market participants.

**Archegos' Collapse had Nothing to Do with its Status as a Family Office**: Archegos' high-risk trading strategy utilizing leverage, multiple counterparties, and Security-Based Swaps could have been orchestrated by any hedge fund or other institutional investor. It had nothing to do with Archegos' status as a family office. Conversely, had Archegos behaved more like the typical family office, none of this would have happened.

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