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November 17, 2010

Via e-mail to: rule-comments@sec.gov

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Family Offices; Release No. IA-3098; (File No. S7-25-10)

Dear Ms. Murphy:

Willkie Farr & Gallagher LLP appreciates this opportunity to comment, on behalf of its clients, on Investment Advisers Act Release No. 3098 (Oct. 12, 2010) (the "Release"),[1] in which the Securities and Exchange Commission proposed a rule (the "Family Office Rule") designed to implement Section 409 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[2] The Section provides for a new statutory exclusion from the definition of "investment adviser" under the Investment Advisers Act of 1940 for a person or entity that meets the definition of a "family office."[3] The Dodd-Frank Act mandates that the Commission define the term "family office" for purposes of the exclusion and requires that the definition "recognize the range of organizational, management, and employment structures and arrangements employed by family offices."[4]

The Commission identified two primary purposes underlying the Family Office Rule: (1) to exclude from regulation under the Advisers Act a family office that is established by a single family and that provides advisory services to that family; and (2) to adopt an exclusion covering single family offices and their investment vehicles sufficiently broad to avoid the Commission and its staff's having to consider a large number of individual exemptions filed with

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1 Family Offices, 75 Fed. Reg. 63753 (proposed Oct. 12, 2010) (to be codified at 17 C.F.R. § 275.202(a)(11)(G)-1), *available at* http://sec.gov/rules/proposed/2010/ia-3098.pdf [hereinafter *The Release*].

2 The Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, § 409 (the provision relevant to the Family Office Rule is codified at 15 U.S.C. § 80b-2(a)(11)(G)).

3 *Id.*

4 *Id.; The Release, supra* note 1, at 75 Fed. Reg. 63754-55.

the Commission by families seeking to operate outside the scope of the Advisers Act.[5] The Commission noted in support of its proposal that a family office arrangement that would qualify for exclusion under the proposal should appropriately not be subject to the Advisers Act and its rules because, among other things, such an arrangement is "unlikely to involve commercial advisory activities, while permitting traditional family office activities involving charities, tax planning, and pooled investing."[6] Among the benefits cited by the Commission for adopting a rule of general applicability to family offices, as opposed to the Commission's past practice of requiring a family office seeking relief from the provisions of the Advisers Act to file an individual request for exemption pursuant to Section 206A of the Advisers Act, is the reduced administrative burden placed on the Commission's staff by virtue of its not having to consider a substantial number of individual requests for relief that may not present controversial facts.[7] We support the Commission's efforts, embodied in the Family Office Rule, to define the scope of the exclusion available to a family office and to provide for general relief by rule rather than by requiring the filing of individual exemptive requests.

We have among our clients numerous families and family-related investment entities that have in the past relied on the exemption from registration under the Advisers Act currently provided by Section 203(b)(3) of the Advisers Act, which will, under the provisions of the Dodd-Frank Act, become unavailable on July 21, 2011. Many, if not most, of those clients believe that their investment operations should be allowed to continue without being subject to the Advisers Act and would seek to rely on the Family Office Rule as adopted. Our comments on the proposed Family Office Rule and the changes we recommend that the Commission make in adopting the Rule that follow below are generally a composite of the views of our clients.

The modifications we recommend that the Commission make to its proposal relate to the scope of the proposal's definition of "family member" and the treatment of charitable organizations under the Rule. In particular, we recommend that the Commission broaden the definition of family member to include certain relatives of the founder of a family office who are not covered by the Rule as proposed, or, at a minimum, enable a family office relying on the Rule to advise a charitable organization established or funded by these relatives. We recommend that the Commission, in addition to broadening the founder's relatives that may be involved in a charitable organization advised by a family office relying on the Rule, enable a a charitable organization to receive a *de minimis* level of funding by persons who are not related to the founder and allow the family office to provide advice to a charitable foundation established and funded by a key employee, as that term is defined in the Rule. We believe that the circumstances under which the Rule would be applicable in accordance with our recommendations present none of the concerns cited by the Commission in the Release relating to a family office's effectively

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5 *The Release, supra* note 1, at 75 Fed. Reg. 63755.

6 *Id.*

7 *Id.* at 75 Fed. Reg. 63760.

providing commercial advisory services without being subject to regulation under the Advisers Act.

Unnecessary Restrictiveness of the Proposed Family Office Rule

The Family Office Rule as proposed would limit the founder's relatives and the types of charitable organizations to which a person or entity relying on the Rule could provide investment advisory services. Under the proposal, a family office relying on the Family Office Rule could advise "family clients," which is defined to include, among others, "family members" and charitable trusts, foundations, or other organizations "established and funded exclusively by one or more family members or former family members."[8] A "family member" for these purposes is defined by the Rule to include: the founders of the family office, the founders' lineal descendents, and those lineal descendants' spouses or spousal equivalents; the parents of the founders; and the siblings of the founders, the siblings' spouses or spousal equivalents, their lineal descendents, and those lineal descendants' spouses or spousal equivalents.

Limiting the relatives of the founders who are deemed family members and limiting the categories of charitable organizations that can be served by a family office in the manner set out in the proposed Family Office Rule, in our view, will act to preclude the Commission from achieving its stated goals with respect to the Rule. To our minds, the limitations will result in a substantial number of families seeking exemptive relief for situations that do not raise the concerns the Rule as proposed was intended to address. The problematic nature of the limitations and our recommendations for recasting the limitations so as to avoid the problems follow below.

Definition of "family member"

The Commission in the Release recognizes that the wealth accumulation of a particular family may have begun with a generation older than that of the founder of the family office.[9] On this basis, the Commission included the parents of the founder of a family office as family members for purposes of the Family Office Rule as proposed. We support the Commission's position that a founder's relatives in preceding generations should be included as family members for purposes of the Family Office Rule and the rationale for that position. We believe that rationale also supports the Rule's definition of family member being expanded to cover a founder's grandparents, the siblings of the founder's parents, and the spouses, spousal equivalents, and lineal descendents of the parents' siblings (the "Extended Family").

In many cases of which we are aware, grandparents, aunts and uncles, and cousins of the founder of a family office may have a close relationship to the founder and indeed may have a closer relationship than other relatives that have been included as family members under the

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8 *Id.* at 75 Fed. Reg. 63755-56, 63757.

9 *Id.* at 75 Fed. Reg. 63756.

proposed Family Office Rule. In the Release, the Commission notes that the Advisers Act was not "designed to regulate the interactions of family members in the management of their own wealth."[10] We believe that, by excluding grandparents, aunts, uncles, and cousins from the definition of family member, the Commission has inadvertently regulated the interactions of family members in managing their wealth. Broadening the definition of family member would avoid this result and would facilitate a family's making its own decision as to which of its members should be able to receive investment advisory services from the family office. At the same time, broadening the definition in the manner we recommend would not result in a family office's providing advisory services in a commercial manner.[11]

Charitable organizations established or funded by members of the Extended Family

The Family Office Rule as proposed would prevent a family office from relying on the Rule if the office provided advisory services to a charitable organization that was not "established and funded exclusively" by one or more relatives of the founder of the family office included in the Rule's definition of family member. The proposed Rule's limitation on those of a founder's relatives who may establish or fund a charitable organization advised by a family office would present numerous practical burdens on a family office seeking to rely on the Family Office Rule. In our experience, it is common for a family office to provide advice to a charitable organization that, for example, was established by an uncle or grandparent of the founder. These charitable organizations are often viewed by the family to be as closely connected with the family as a charitable organization that was funded by persons who fall within the definition of family member under the proposed Rule. Moreover, a charitable organization, particularly one established in the relatively distant past, may not as a practical matter be able to determine whether it was funded only by relatives that are family members under the Rule as proposed or the amount of its assets attributable to relatives who are not covered by the proposed Rule.

Broadening the definition of family member to include members of the Extended Family would alleviate the concerns we have as to the limitations placed on the charitable organizations that could be served under the Family Office Rule as proposed. We submit that, if the Commission determines not to generally expand the definition of family member for purposes of the Rule as we suggest above, it should nonetheless broaden the categories of charitable organizations that can be served by a family office relying on the Rule to include any such charitable organization established or funded by a member of the Extended Family. Allowing a family office to provide advisory services to such a charitable organization would address the

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10 *Id.* at 75 Fed. Reg. 63755.

11 One of our clients has expressed to us support for the Commission's expanding the definition of family member in the Family Office Rule to include not only the relatives of the founder described in the text above, but also a step-parent of a founder. We believe the same reasons for expanding that the term to include members of the Extended Family support the Commission's final rule deeming a step-parent of a founder to be a family member. The Commission's adopting this position would be consistent with the proposed Rule's deeming the parents of a founder and the step-children of the founder to be family members for purposes of the Rule.

practical problems we have identified above and would be consistent with the purposes of the Rule; the charitable organization would have a close connection to members of a family and would not resemble commercial clients of an investment adviser.

A charitable organization funded in small part by non-relatives of the founder

As proposed, the Family Office Rule would prohibit a family office from relying on the Rule if it advises a charitable organization that accepted funding, no matter how *de minimis* the amount, from a person who does not meet the Rule's definition of family member. We submit, on the basis of discussions with our clients, that it is common for a charitable organization funded by family members to receive some funding from non-family members, including, for example, grants from government agencies whose purpose is to fund charitable activities. A charitable organization that receives funding of this sort would not have diminished its ties with the family by accepting the funding, but would be precluded under the Commission's proposal from receiving advisory services from the family office.

Enabling a family office relying on the Family Office Rule to provide advisory services to a charitable organization funded in small part by a non-family member would seem to be quite consistent with the purposes of the Rule. We acknowledge that a family office's providing advisory services to a charitable foundation that receives a significant amount of its funding from non-family members could be viewed as providing services resembling commercial advisory services because of the large non-family component of the foundation's assets managed by the family office. A family office providing advisory services to a charitable organization that was funded predominately by family members, on the other hand, would not raise this concern.[12] Such a charitable organization would engage in its activities funded largely by family members and would have only a *de minimis* level of donations from non-family members.

A charitable foundation funded by a key employee of the family office

The Release recognizes the potential benefits to a family office of certain employees, termed "key employees" under the proposal, investing alongside family members and receiving advisory services from the family office. The benefits cited with respect to such an arrangement in the Release include better aligning these employees' interests with those of the family members served by the family office and providing the family office with flexibility in structuring compensation arrangements with the employees. Under the Family Office Rule as proposed, key employees are limited to only those who "are likely to be in a position or have a

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12 "Predominately" funded by family members for these purposes could be defined, for example, to require that family members provide at least 85% of the funding of the charitable organization. Such a percentage requirement finds some support in the Dodd-Frank Act itself. In an albeit different context, the Act defines a company to be "predominantly engaged" in financial activities if it derives at least 85% of its gross revenues from activities that are financial in nature. The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, § 102.

level of knowledge and experience in financial matters sufficient to be able to evaluate the risk and take steps to protect themselves."[13]

The proposed Family Office Rule would allow a family office relying on the Rule to manage the assets of a key employee of the family office, but, by its express terms, would appear not to cover the family office's providing advisory services to a charitable foundation established and funded by the key employee, either directly or through a pooled investment vehicle managed by the family office. To our minds, the policy reasons that the Commission identified for allowing a key employee to receive advisory services together with family members apply equally to a charitable foundation established and predominately funded by the key employee. The key employee's interests would be aligned with the family's, and the key employee would be in the same position to evaluate the services of the family office for his or her foundation as for his or her own investments. Enabling a family office relying on the Family Office Rule to provide advisory services to a charitable organization established and predominately funded by a key employee would thus be quite consistent with the purposes of the Rule.

Recommended Modifications to the Family Office Rule

We recommend that the Commission address the aspects we have identified above of the Family Office Rule as proposed by modifying the Rule to broaden the definition of family member and the categories of charitable organizations to which a family office relying on the Rule could provide advisory services. The Rule should be modified to: (1) include as family members under the Rule a founder's Extended Family or, at a minimum, include as a permitted client of a family office relying on the Rule a charitable foundation, organization, or trust established and predominately funded by any member of the Extended Family; (2) permit a family office relying on the Rule to advise a charitable organization that is funded predominately, but not exclusively, by family members; and (3) permit as a client of the family office a charitable organization established and predominately funded by a key employee of the family office. We believe that our recommendations would further the purposes of the Family Office Rule, would not raise the policy concerns articulated by the Commission in the Release, and would be consistent with the Dodd-Frank Act's mandate to the Commission in adopting the Rule.

If modifications to the Family Office Rule of the sort we are recommending are not made by the Commission, many family offices would, we believe, need to seek individual exemptive relief from the Commission under circumstances that do not pose the sorts of issues that warrant individual consideration under the Commission's exemptive process. We recognize the potential harm to investors that could result from an overly inclusive category of persons or entities that can be served by a family office relying on the Rule. We submit, however, that requiring a family office that would be able to rely on the Family Office Rule but for the circumstances described above to seek individual exemptive relief would frustrate the policy purposes of the

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13 *Id.* at 75 Fed. Reg. 63758.

Rule to the detriment of investors, family offices, and the Commission and its staff. Under the Rule as proposed, the Commission and its staff would likely need to spend significant time and resources addressing exemptive applications filed by family offices that do not present significant investor protection or other policy concerns. Addressing the situations described above by expanding the Rule in the manner we recommend would avoid an unnecessary burden on the Commission and its staff without harm to investors that may need the protections of the Advisers Act.

Support for Other Comments

We note that our clients, in addition to having the comments set out above on the Family Office Rule as proposed, generally support the recommendations and comments submitted to the Commission by the Private Investors Coalition, Inc. in its letter dated November 11, 2010. Some of our clients have asked that we specifically express their strong support for the Coalition's recommendations that the Commission's final version of the Rule require only that a family office be formed by, operated primarily for the benefit of, or subject to the control of family members. Enabling a family office that is not wholly owned by family members, so long as the family office is formed by the family, operated for the benefit of the family, or subject to the control of the family, to rely on the Rule would not raise concerns relating to the family office's operating as a commercial investment advisory business and would reflect better than the proposed Rule the organizational arrangements commonly employed by family offices. We believe that this change to the proposed Rule, with the others advocated by the Coalition, further the purposes underlying the Rule set out by the Commission in the Release (and in particular avoid the diversion of Commission resources needed to consider a large number of individual exemptions) without adversely affecting in any way the interests of investors in need of the protections afforded by the Advisers Act.

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We appreciate the efforts of the Commission and its staff in connection with the Family Office Rule and would encourage the Commission to act expeditiously to adopt a final version of the Rule. The Commission's so acting would enable families and their investment vehicles to make changes in their operations so as to be able to rely on the final Rule or to assess their need to file for exemptive relief under Section 206A of the Advisers Act. We hope the Commission and its staff find our comments above helpful, and we would be pleased to discuss any aspect of the letter with the Commission or its staff. Questions regarding this letter may be directed to Daniel Schloendorn at (212) 728-8265 or Jai Massari at (202) 303-1133.

Very truly yours,

Willkie Farr & Gallagher LLP

WILLKIE FARR & GALLAGHER LLP