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From: Thomas V. Cliff
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To: Securities and Exchange Commission

Re: File Number S7-25-10
Comments on rule to define "family office" that would be excluded from the definition of an investment adviser under the Investment Advisers Act of 1940

One portion of the proposed rule exposes charities to the investment whims of those who are their sole funders. A second portion seems inconsistent with expressions of Congressional intent in the Defense of Marriage Act (DOMA). Two additional portions unreasonably restrict the ability of non-family members and former family members to separate their assets from those of the founding family.

Defining "Family Clients"

The first appears in paragraph 17 (1) of the commentary on the proposed rule, defining "family clients" to include "charities established and funded exclusively by family members or former family members." Federal policy exempts gifts to certain charities from gift taxation, and exempts income of certain charities from income taxation. The gift tax exemption reflects a public policy to encourage private philanthropy.

The recent Bernie Madoff scandal ruined a number of charitable foundations because their founders contrived to give investment management responsibility to a company Mr. Madoff controlled (see *The New York Times*, May 25, 2010, list of defrauded individuals and entities). The founders were taken in by Mr. Madoff as to their personal assets. Financial ruin for their individually funded charities occurred because the founders extended their personal preferences to entities created for the public good.

The proposed rule brings "charities established and funded exclusively by family members or former family members" within the definition of "family clients" that an "excluded family office" may serve. This step allows family offices to manage the investments of such a charity. The rule seems to view the assets of such a charity as though they were the donor's to control, which ignores fiduciary law that requires such assets to be segregated from the donor's assets and managed to further the mission of the charity, not the interests of the donor.

One probable rationale for including such charities, although it does not appear in the explanation for the proposed rule, is to promote efficiency by managing their assets in conjunction with a presumably larger pool of family assets, thereby spreading overhead costs over the combined pool of assets. Charities certainly must pursue efficiency and cost control. Using the donor's family office to manage the charity's assets might address these objectives,

but it also exposes the charity's mission to the investment whims of the donor through the family office. Because the rule abets this exposure, it must be modified.

Moreover, effectively pooling the assets of such a charity with those of the donor might reduce the investment management costs of the charity, but it would also reduce the investment management costs of the donor, suggesting a conflict of interest in the decision to pool the assets for investment purposes. The donor must not benefit from investment decisions of the charity. Because the rule abets this conflict of interest, it must be modified.

Finally some donors create charitable foundations as tools for maintaining family control over a publicly-traded company by placing a large block of voting shares in the hands of an ostensibly independent entity that the donor in fact controls. Including such charities in the "family clients" definition facilitates such a control strategy. The question should be asked, is facilitating family control of a publicly traded company an intended consequence of the proposed rule? If it is intended, the question becomes, is this a legitimate purpose of regulation by an agency whose mandate is to ensure that securities markets function openly, with transparency to investors?

"Spousal Equivalents"

Proposed rule 202(a)(11)(G)-1(b)(1) defines the term "family member" to include a new term of art, one absent from normal discourse: "spousal equivalents." Paragraph 23 of the commentary on the proposed rule admits that the agency is "not aware of any applicant that requested that spousal equivalents be included as a permitted client of any family office …." In the absence of a suggested benefit, why make the change? Is this portion of the proposed rule a solution in search of a problem?

Paragraph 24 of the commentary on the proposed rule defines the term as "a cohabitant occupying a relationship generally equivalent to that of a spouse." Including this category of person is contrary to the intent of the federal Defense of Marriage Act, 1 USC section 7, 28 USC section 1738 (C) (known as DOMA). Including this category means extending the benefit of the "family member" definition, for example, to a same-sex partner of a lineal descendant of the founder who has become the spouse of the descendant by virtue of a marriage ceremony conducted in a state that provides for same-sex marriage. The proposed rule would amount to federal law ratifying a state law that DOMA clearly means should not govern federal law. It is a needlessly proactive effort at political correctness. For this reason the proposed regulation must be modified to delete the term "spousal equivalents."

Involuntary Transfers

Proposed rule 202 (a)(11)(G)-1(b)(1) would allow a family office to administer assets transferred to non-family members. This revision should be eliminated from the proposed regulations. Unforeseeable consequences lurk in this proposal. It would open the way to a very broad range of possible bequests to parties who have no other interests shared with the founding

family. The result would be to deny non-family members the right to make their own investment decisions and would erode an established rule intended to acknowledge shared family interests.

Former Family Members

The same rationale leads to a recommendation against extending eligibility for special treatment to former family members, for example, former spouses. Allowing the family office to continue to manage assets for former family members seems like a way to enable former spouses who are family members to control the investments of former spouses who are not family members, thus preserving the family's control, for example, over family businesses.

Respectfully submitted,

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