2 November, 2010

Dear Mary Schapiro, Chairman, Securities and Exchange Commission and Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, Ms. Casey, Ms. Walter, et Messrs. Aguilar and Paredes, Commissioners, Securities and Exchange Commission,

I write in support of the proposed Rule described in Release No. IA-3098; File No. S7-25-10 (RIN 3235-AK66). The modern family office must fall outside the definition of an investment adviser under the Investment Advisers Act of 1940 (Advisers Act).

The purpose and intent of the Advisers Act is one of consumer protection, rather than securities regulation. However, in the case of the family office, the consumer creates the institution offering him advice. That which was written to protect children from strangers now instead operates to protect the parent from the child. It is an unfortunate accident of history – likely in part due to the rarity of concentrated wealth on the scale of today's wealthy families and in part due to the lack of sophisticated institutions among even the savvy wealthy families of the 1930's – that the modern family office falls within the registration requirements of the Advisers Act.

The instant issue is separate and distinguishable from other questions regarding the applicability of the Advisers Act (see cf. Financial Planning Association v. Securities and Exchange Commission and the issue of Rule 202(a)(11) exemption). Family offices, and in particular single family offices, must be able to give advice regarding securities among a range of other constituent portfolio services. Further, it is neither practical nor desirable for family offices to obtain 202(a)(11) exemption orders individually, as has been done in the past. The scale of the issue, the prevalence of family offices, and the ever-increasing sophistication of families in the $100MM+ net worth range demands a blanket rule rather than a piecemeal solution.

The next twenty years represent the largest intergenerational transfer of privately-held wealth in human history. Family offices are an important conduit for managing this wealth transfer. Already, family offices are forced, in part due to SEC regulation, to operate less efficiently than might otherwise be possible. Many offices, if not the majority of U.S.-based family offices, are designed to take advantage of the 203(b)(3) registration exemption. Other offices are optimized around the securities laws of multiple jurisdictions, or have relationships that require complex subsidiaries or external special purpose vehicles. There is no need to further complicate the design and operation of family offices.

Further, we live in a time of increasing international competition in regulatory frameworks. Make no mistake, families in the $100MM+ net worth range have many choices as to where to reside, which citizenships to hold, and where their family offices may be located. Many of today's fortunes are not created in New York or Chicago, but are born of overseas enterprises. In order to attract the offices of families with substantial wealth, and to retain American families who are able to live and establish offices overseas, the United States must offer an attractive regulatory environment for wealthy families. The exemption of family offices from the definition of an investment adviser under the Advisers Act is one important step in this direction.

However, additional steps are needed. In order for family offices to attract the best talent from banks, business schools, and elsewhere, investment professionals who work in the family office must be allowed to co-invest or invest in parallel vehicles. This not only better-aligns the incentives of the professional with those of the family, but reduces inefficiency that will otherwise exist, namely bonuses or other remuneration with high correlation to investment performance in place of co-investment. Any key employee (key employee being a knowledgeable employee under Rule 205-3 under the Advisers Act) should be allowed to negotiate co-investment or similar opportunities as a function of his employment agreement with the family's office. In general, these compensation relationships should be assigned through the negotiation of bilateral contracts rather than through wholesale regulation, recognizing the unique circumstances of various family offices.

Beyond the scope of key employees, others may benefit from family investment opportunities, such as a vehicle created to invest in a given venture or piece of real estate, but should not benefit directly from investment advice or information from within the family office. Defining the scope of services by the scope of clients served has offers substantial utility, as the existing definitions provide no legal scalpel sharp enough to cut typical investment advisory services away from the family office. Where exceptions exist, exemptive orders may be properly sought.

Finally, it is crucial that the SEC understand that family offices are generally run at a breakeven or slight net-gain cashflow position. Hence, the purpose is not to create a profit center in the family office (which distinguishes family offices from commercial investment advisory and family-run investment advisory businesses, both of which are properly regulated by the SEC and the Advisers Act), but to use the family office to increase information and operational efficiency available to the family. In so doing, family offices increase the rents that flow to the family, allow family members to increase their marginal product of labor and raise their real wages, and create opportunities for family members to make more profitable and innovative investments than would otherwise be possible. Needless to say, operational efficiency, more productive workers, and the incorporation of the best available information in managing fortunes of this size bring countless positive externalities that the SEC should applaud and encourage.

Thank you, Madam Chairman and Commissioners several, for this opportunity to comment on the proposed Rule.

Sincerely,

Karl T. Muth
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