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McGUIREWOODS

November 18, 2010

Via email to: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attention: Elizabeth M. Murphy, Secretary

Re: Family Offices, Proposed Rule
Release No. IA-3098; File No. S7-25-10

Dear Ms. Murphy:

In Release No. IA-3098, the Securities and Exchange Commission (SEC) proposed a definition of family office, and asked for comments on that proposed definition.

We have the following comment concerning the proposed rule. We ask that you reconsider the part of the rule which requires that a family office needs to be owned by family members. There are various situations where the family office may be owned by the adviser rather than family members. For example, an individual who is not a family member may act as the adviser for one or more family members. In addition, a former family member may act as an adviser to one or more family members. This kind of situation could arise as a result of a divorce.

It would not seem to make sense to require the family to form an entity and employ the adviser. Family clients should be permitted under the rule to engage an adviser whose only advisory clients are family clients. In both cases the family can control the "profit" through negotiation of advisory fees paid.

The proposed rule requires that all advisory clients of a family office be family clients. As a result, it would seem that advisory fees and "ownership" are the same thing.

Accordingly, we suggest that the proposed rule be revised to permit the family office to be owned and controlled by the adviser or employees of the adviser.

In addition, this firm represents a family with respect to certain business and estate tax planning matters. The family has a family office which has existed, in some form, for more than 50 years. We do not represent the family or its family office with respect to SEC regulatory matters and have not advised the family or its family office with respect to the above-referenced rulemaking.

The family office wishes to comment on the above-referenced rulemaking, but wishes to maintain the family's privacy. It has prepared its own comment in the form of the enclosed "mark-up" of the proposed rule and has requested that we submit this comment on its behalf. This mark-up follows below.

I am available to discuss our comment at 202-857-1716 or dpankey@mcguirewoods.com. If the SEC or Staff wishes to discuss the mark-up below, I would be glad to establish direct contact with the family office which prepared this mark-up.

Respectfully submitted,

David H. Pankey

Proposed Rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940
Release No. IA-3098; File No. S7-25-10

Below is a "redlined" version of the proposed rule reflecting the comments of a single family office which prefers to remain anonymous.

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§ 27-5.202(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, 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 ~~four months~~ one year following the transfer of assets resulting from the involuntary event;

Comment: Although this has not been an issue for our family office or family business entity, we suggest a longer transition period following such an involuntary transfer. At a minimum, a nine month transition period would cover the six months "notice to known creditors" period under state laws governing most estates and would allow the recipient of the involuntary transfer to determine if he/she would like to make a qualified disclaimer under Internal Revenue Code Section 2518. We suggest the rule allow for a slightly longer period to accommodate both the illiquidity of many family office investments and the lengthy legal processes involved in terminating trusts and administering estates.

(2) Is wholly owned and controlled (directly or indirectly) by ~~family members~~ family clients; and

Comment: We would prefer that the proposed rule either be expanded to include family offices owned by *family clients*[1] or clarified to indicate what constitutes "wholly owned and controlled (directly or indirectly)."

The definition of *family member* does not include family business entities or trusts. Our family office is a subsidiary of the family operating business, a corporation. The family corporation is owned by various irrevocable trusts created by family members for the benefit of family members. Therefore, unless the word "indirectly" is construed broadly, neither our family corporation nor our family office fit within the definition of a *family office*.

Alternatively, if the SEC were to clarify that it interprets the phrase "wholly owned and controlled (directly or indirectly) by *family members*" to mean "wholly owned and controlled by or for the benefit of *family members*," then family offices owned by business entities or trusts should fit within the proposed definition.

(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~~clients; or

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[1] All italicized terms within our comments have the meaning as defined in the proposed rule.

Comment: For estate, gift, or income tax planning purposes, some family companies may be partially or wholly owned by other family companies or trusts. There is no reason to exclude such *family clients* from the grandfathering provisions of the proposed rule.

(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) *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.

(2) *Family client* means:

(i) Any family member;

(ii) Any key employee;

(iii) Any charitable foundation, charitable organization, or charitable trust, in each case ~~established and funded exclusively~~ established or controlled, directly or indirectly, by one or more family members or former family members;

Comment: The "established and funded exclusively" language in the proposed rule is too limiting. Our family corporation makes annual contributions to one of our family foundations. Our family corporation is not a *family member* as that term is defined in the proposed rule. Therefore, the family foundation, because it has accepted contributions from our family corporation, would not be a permitted client of the family office.

As a matter of public policy, charitable donations of any sort should be encouraged. There is no reason to prohibit private foundations from receiving donations from non-family members. For example, there is no reason for the SEC to prefer that Warren Buffett create his own family foundation rather than contribute his wealth to the Bill & Melinda Gates Foundation.

(iv) Any trust or estate formed by or for the primary ~~existing for the sole~~ benefit of one or more family clients;

Comment: The "existing solely for" language of the proposed rule is too limiting. Under the proposed rule, any charitable split interest trust would be disallowed as a *family client* if the charitable lead or remainder interest belongs to a public charity. In our family, many charitable

remainder trusts do terminate in favor of a family foundation, but, typically, the grantor has retained a testamentary right to designate a different charity as the remainder beneficiary. As a matter of public policy, we believe the creation of such charitable trusts should be encouraged.

Very few trusts or estates are for the "sole benefit" of *family clients*. This definition would preclude all reminder interests, bequests, and/or legacies to non-family members, such as friends or public charities. If a trust has been formed by or for the primary benefit of a *family client*, it should be a permissible *family client* under the proposed rule.

Any estate of a family member should be a permissible *family client*, regardless of who benefits from the estate.

> (v) Any limited liability company, partnership, corporation, or other entity wholly owned and controlled (directly or indirectly) exclusively by, and operated for the sole benefit of, one or more 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;
>
> (vi) Any former family member~~, provided that from and after becoming a former family member the individual 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 time that the individual became a former family member, except that a former family member shall be permitted to receive investment advice from the family office with respect to additional investments that the former family member 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 family member~~; or

Comment: We believe there should be a distinction between the way in which a *former family member* and a *former key employee* are treated under the rule. *Former family members*, such as former spouses or former stepchildren, may remain close to other *family members* and may continue to be treated as members of the family. For example, a divorced spouse may be the parent of a *lineal descendant* who is running the family business. There is no reason to exclude such a divorced spouse from continuing to receive investment advice from the family office. We believe it should be up to the *family members* to determine whether or not to continue providing all family office services to *former family members*.

> (vii) 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.

(viii) Employee benefit plans as defined under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), bonus or incentive compensation plans that are exempted from ERISA, and qualified pension, profit sharing or stock bonus plans, non-qualified deferred compensation plans and welfare benefit funds subject to the Internal Revenue Code of 1986, as amended, that are sponsored by the family office or any family client.

Comment: This language is borrowed from the comments submitted to the Commission by Martin Lybecker on behalf of the Private Investor Coalition prior to the issuance of the proposed rule.

Some family business entities are themselves family offices. Some of those business entities, as well as other types of family offices, maintain employee benefit plans for current and past employees. As a matter of public policy, the existence of such plans should be encouraged and should not cause a family business entity or family office to not qualify as a *family office* under the proposed rule. Such plans should be permissible *family clients*

(3) *Family member* means:

(i) the founders, their lineal descendants (including by adoption and stepchildren), and such lineal descendants' spouses or spousal equivalents;

(ii) the parents of the founders; ~~and~~

(iii) the siblings of the founders and such siblings' spouses or spousal equivalents and their lineal descendants (including by adoption and stepchildren) and such lineal descendants' spouses or spousal equivalents; and

(iv) the siblings, sisters-in-law, brothers-in-law, nieces and nephews of a lineal descendant's spouse or spousal equivalent.

Comment: We believe the SEC should consider expanding the definition of *family member* to include a spouse's siblings, sisters-in-law, brothers-in-law, nieces and nephews. Many *family members* develop close relationships with their spouse's siblings, sisters-in-law and brothers-in-law. Also, most people consider their spouse's nieces and nephews to be their own nieces and nephews. The English language and American culture draw no distinction between the children of our siblings and the children of our spouse's siblings. Both are our nieces and nephews. The proposed rule should reflect our culture's tradition, that a person's family includes the family of his or her spouse or spousal equivalent.

(4) *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.

(5) *Founders* means the natural person and his or her spouse or spousal equivalent for whose benefit the family office was established and any subsequent spouse of such individuals.

(6) *Key employee* means any natural person (including any person who holds a joint, community property, or other similar shared ownership interest with that person's spouse or spousal equivalent) who is an executive officer, director, trustee, general partner, or person serving in a similar capacity of the family office or any employee of the 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, provided that such employee has been performing such functions and duties for or on behalf of the family office, or substantially similar functions or duties for or on behalf of another company, for at least 12 months.

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