SIDLEY AUSTIN LLP
SIDLEY

SIDLEY AUSTIN LLP
ONE SOUTH DEARBORN STREET
CHICAGO, IL 60603
(312) 853 7000
(312) 853 7036 FAX

BEIJING
BRUSSELS
CHICAGO
DALLAS
FRANKFURT
GENEVA
HONG KONG
LONDON
LOS ANGELES

NEW YORK
PALO ALTO
SAN FRANCISCO
SHANGHAI
SINGAPORE
SYDNEY
TOKYO
WASHINGTON, D.C.

mruiz@sidley.com
(312) 853 7187

FOUNDED 1866

November 18, 2010

Submitted via EMAIL to rule-comments@sec.gov

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

Re: Proposed Rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940, as amended (SEC File Number S7-25-10)

Dear Ms. Murphy:

This letter is submitted by Sidley Austin LLP in response to the request by the Securities and Exchange Commission (the "Commission") for comment on the proposed rule to define "family offices" that would be excluded from the definition of "investment adviser" under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), as contemplated by Section 409 of the Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[1] We represent many family offices, but are writing on behalf of a single family office to which these issues are very important. We strongly support the timely adoption of a robust, flexible and durable family office rule in accordance with the mandate provided by Congress in Section 409 of Dodd-Frank. Given that Dodd-Frank greatly alters the scope of investment advisers that will be subject to Commission oversight, we believe that both the Commission and the many family offices currently in existence would be best served by a family office rule that both truly separates commercial investment advisory firms from family offices and is sufficiently broad and flexible to be relied upon by the vast majority of family offices notwithstanding the diverse array of structures currently in use by family offices.

Section 409(b)(1) of Dodd-Frank mandates that the Commission's final family office rule must be "consistent" with the previous exemptive policy of the Commission; however, we note that the Commission has issued only approximately a dozen exemptive orders in the past 70 years to

[1] *See* Investment Advisers Act Release No. 3098, 75 FR 63573-63763 (October 18, 2010) (the "Proposed Rule").

family offices. In the proposed rule release, the Commission itself states that the Commission believes there are currently between 2,500 and 3,000 family offices in operation, managing more than $1.2 trillion in assets.[2] Each of the exemptive orders issued by the Commission has been highly particularized to the facts of the specific requesting family office and other family offices are not able to rely on those facts for comfort that they will not themselves be deemed to be investment advisers for purposes of the Advisers Act. Given this limited experience with family offices, the Commission should tread very carefully to guard against adopting overly rigid or prescriptive rules.

The limited number of exemptive orders granted to family offices is in large part due to the availability of other exemptions and exclusions from regulation under the Advisers Act. Given the time and expense often involved in obtaining an exemptive order, most family offices (particularly smaller family offices) have sought to rely on Section 203(b)(3) of the Advisers Act for exemption from registration with the Commission. Section 203(b)(3) will be eliminated by Dodd-Frank effective July 2011, which will put a great deal of pressure on the Commission's family office rule to encompass all true family offices that have to date relied on that exemption. While we appreciate the Commission's desire to avoid crafting a family office rule that is subject to abuse and misapplication by advisory firms that are not true family offices, the Commission must remain cognizant that its experience with family offices is based on a small number of data points compared with the total family office universe. Although Congress, as a baseline requirement, called upon the Commission to be consistent with its previous exemptive policies with respect to family offices, Congress also recognized its extraordinarily limited scope of this exemptive policy when it enacted Section 409(b)(2) of Dodd-Frank, which requires the Commission to be mindful of "the range of organizational, management, and employment structures and arrangements employed by family offices."

Although we applaud the Commission for being thoughtful and deliberate in fulfilling its mandate under both Sections 409(b)(1) and (2) of Dodd-Frank, particularly by issuing proposed rules so quickly after enactment of Dodd-Frank, we also believe that there are several areas in which the Proposed Rule should be improved to ensure that the Commission's valuable resources are not directed at addressing repeated requests from technically non-conforming family offices for particularized exemptive order relief and to provide comfort to existing and future family offices that they can operate within the contours of the final family office rule without unnecessarily diverging from their existing structures, which in many cases have been in place for many years or even decades and were established for reasons entirely independent of the Advisers Act. Although the Commission will retain its ability to exempt these technically non-conforming family offices from the definition of an "investment adviser", we believe this authority should be used only in truly unusual circumstances not capable of being anticipated at this time. The final rule itself should be sufficiently broad to be relied upon by the entire range of diverse family office structures currently in use, as well as those that can reasonably be expected to be in use in the future. For a detailed analysis of many of the structures in use by family offices, we direct the Commission to a separate comment letter submitted by The Private Investor Coalition, Inc. (the "Coalition"). While we concur with the points raised in the Coalition's comment letter, we are writing separately to comment on several additional points and to provide further emphasis on certain of the points raised in that letter.

---

[2] *Id.* at 63754.

Comments on the Proposed Rule

1. Definitions of "Family Member" and "Family Client"

The Proposed Rule defines a family office, in relevant part, as a company owned and controlled exclusively by "family members" with no clients other than "family clients." Family clients would include the following: (1) family members; (2) key employees; (3) charitable foundations, organizations and trusts established and funded exclusively by one or more family members or former family members (referred to herein as "family charities" and discussed in further detail below); (4) trusts and estates existing for the sole benefit of one or more family clients (also discussed in further detail below); (5) certain entities wholly owned and controlled by, and operated for the benefit of, family members; (6) former family members (subject to limitations discussed below); and (7) former key employees (subject to limitations discussed below).

Family members would include the following: (1) the founders and their lineal descendants, and such lineal descendants' spouses and spousal equivalents; (2) the parents of the founders; and (3) the siblings of the founders and such siblings' spouses or spousal equivalents and their lineal descendants and such lineal descendants' spouses or spousal equivalents. Lineal descendents would include those who become family members through adoption or marriage of a parent into the family (*i.e.*, stepchildren). We entirely support the inclusion of adopted children, step-children and spousal equivalents as family members. While the Commission has not always viewed persons in each of these categories as being family members for the purpose of issuing exemptive order relief, we believe that including all three categories rightly recognizes the diverse ways in which modern families are structured and will be structured going forward. Given this recognition, we also think it would be sensible to include not merely the genetic parents of the founders, but also their adoptive or step parents, if applicable.

The Founders of the Family Office

The Proposed Rule defines the "founders" of the family office as "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." Although the Proposed Rule includes as a "family member" the parents of the founders of a family office, the family tree that defines the contours of a family office springs from the founders and the founders define the persons and entities to whom the family office may provide investment advice. However, the proposed definition of "founder" disregards the fact that the person responsible for generating a family's wealth may be several generations removed from the person or persons who formed the family office. In many cases the family's economic "patriarch" or "matriarch" may be a parent, grandparent, or an even further removed lineal progenitor. This patriarch or matriarch may be long-deceased by the time the family office is formed and therefore it would be difficult to argue that the family office was established for such person or persons' benefit (it would be more accurate to say that the family office was formed in such person or persons' memory). We believe it would be an unfortunate, and likely unintended, consequence if certain direct lineal descendants of the patriarch or matriarch of the family were not treated as family members, while other direct lineal descendents were treated as family members merely because they were fortunate enough to be included in the same line of descent as the person or persons who formed the family office. All such descendants are likely to be the beneficiaries of the family's wealth and may seek to receive advisory services from the family office.

In addition, a given family may not have one specifically identifiable patriarch or matriarch. Many families achieve their wealth over several generations. Other families may have wealth generated primarily by a younger member of the family (the Commission recognizes this possibility in the Proposed Rule release). In this latter case, the person or persons who form the family office may actually be the parents or grandparents of the person or persons responsible for generating the bulk of the family's wealth. The proposed definition of "founder", through which the family tree of the family office is defined (except in the limited instance of inclusion of the founders' parents and siblings and their respective spouses and spousal equivalents) is therefore unnecessarily prescriptive.

We believe that the "founders" of a family office should be the persons of the highest generation who created a substantial portion of the family's wealth (whether or not such persons are living at the time the family office is formed) or, at the election of the family office, the person or persons who formed the family office. This test is flexible but not entirely open-ended, and will allow the family office itself to define the scope of the family members to which the family office may provide investment advisory services. The scope of one's family is, after all, an intensely personal and private matter best addressed within the family itself.

Descendants of the founders as we have defined them will likely constitute all the individuals to whom the wealth of the family has passed, and therefore likely will constitute the individuals to whom it is appropriate for the family office to provide investment advice.

Consider the example of an individual with children who in turn collectively have several children. The individual accumulates wealth which he or she determines to pass along to his or her grandchildren in trust upon his or her death. Upon the person's death, the wealth is allocated to each of the grandchildren evenly. Under our suggested scope of the family office, no matter who actually creates the family office all these grandchildren would be eligible to participate in a family office because they all are descendants of the wealth creator. However, if such family office is created by one or a few of the grandchildren after the death of the wealth creator, the Proposed Rule would exclude the other grandchildren, as cousins of the wealth creator would not be family members under the Proposed Rule. As these individuals each received their wealth from the same family member and are close enough to handle their affairs internally as a family, the appropriate definition of "family member" should include them all.

Furthermore, wealth may take several generations to be created. Additionally, upon the sale of a family business several generations may receive the proceeds that will be used in the family office. Under the Proposed Rule, the scope of a family office may exclude several beneficiaries of wealth creators from earlier generations if one of the wealth creators from a subsequent generation creates the family office. The Commission's proposed definition would encourage families to rush into creating family offices before they otherwise might, would arbitrarily penalize families that did not form within the life of the first wealth creator, and may lead to several generations of wealth creators within one family inefficiently creating multiple family offices (which, by the terms of the Proposed Rule, could not be operated jointly without registration due to the inability to operate unregistered multi-family offices, even where the families are closely related). By identifying the founder in the manner we propose, as described above, family members who receive wealth from an earlier generation will not be excluded from participation, families will not be arbitrarily punished or rewarded based on when they decided to form a family office, and families of successive generations of wealth can more easily and efficiently form one family office.

In order to accommodate situations in which the wealth creators of a family are younger people (as the Commission as recognized as a possibility in the Proposed Rule release), we also believe that the final rule should include as family members not merely the parents of the founders but also the grandparents of the founders and any persons in any higher generation who are alive at the time the family office is formed, as well as the siblings of each of the foregoing persons.

Benefit Plans as Family Clients

The Proposed Rule is silent on whether employee benefit plans, bonus and incentive compensation plans, pension plans, deferred compensation plans and similar plans (collectively, "Plans") should be treated as clients of the family office. We believe that any limitation on allowing a family office to maintain such Plans (including selecting and retaining the advisors, trustees, administrators and other service providers to such Plans) will constitute a serious impediment to the ability of the family office to compete for talented employees with traditional advisory firms and other businesses. We therefore believe that the definition of "family client" should be expanded to include Plans operated for the benefit of all employees and former employees of the family office, whether or not those employees or former employees are (or were during the term of their employment) "key employees" within the meaning of the Proposed Rule. If Plans are not included in the definition of "family client," a tension between the Proposed Rule and provisions of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), may interfere with a family office's ability to hire and retain qualified employees. Plans subject to ERISA must be non-discriminatory, meaning all employees, not merely "knowledgeable employees", must be eligible to participate. Other plans, such as bonus or incentive compensation plans, qualified pension plans, profit sharing or stock bonus plans, non-qualified deferred compensation plans and welfare benefit funds, while they may not be required by law to be non-discriminatory, are customarily made available to a broader group of employees than merely those who would be "key employees" under the Proposed Rule. Alternatively, we ask that the Commission provide guidance to the effect that merely selecting and retaining the service providers to a Plan, where the family office does not itself make investment decisions for the Plan, will not cause the Plan to become a client of the family office.

Family Trust and Charities

"Family clients" should include trusts and estates, as suggested by the Proposed Rule, but permitted trusts should be expanded to include trusts for the primary benefit of family members and public or private charities. Family members may be the persons who primarily, though not exclusively, originate foundations or substantially fund foundations. The Commission should also allow a family office to include as a family client a trust that has contingent interests held by an individual or charity outside the family, as long as the contingency has not yet occurred. The same treatment should apply to split interests, *i.e.*, interests in which both family members and non-family members are beneficiaries. The Commission has already used a similar rationale with respect to primary beneficiaries in Rule 203(b)(3)-1, as it applies now to the counting of clients.

2. Ownership and Control of the Family Office

The Proposed Rule would require that a family office be a company that is wholly-owned and controlled (directly or indirectly) by family members. While we were pleased to see that the Commission considered the possibility that a family member's ability to contribute to the *control* of the family office may be indirect, we believe the Proposed Rule is ambiguous about whether a family member may hold his or her *ownership* interest in the family office indirectly, for example as the beneficiary of a trust that holds the ownership interest. As the Commission is no doubt aware, family offices may be owned in any number of ways that do not involve direct ownership by family members in their individual capacities. We believe the final rule should recognize the ability of family offices to be owned not only by family members, but also by family clients, which would encompass trusts and other vehicles that frequently hold ownership interests in a family office.

Most importantly, the Commission should allow for ownership in family offices by family trusts or other estate planning vehicles, rather than by family members directly. Often the capital needed to create a family office will reside in one or more family trusts. Further, because some trusts may continue for multiple generations and may benefit multiple family members, they may be preferred as owners of the family office to limit ownership changes that would otherwise occur as individual owners die and to reduce the number of owners of the family office. In addition, because the trustees of the various trusts are typically directly responsible for the investment of the trust assets, it makes sense to allow those trusts to be the owners of the family office.

We also believe the Commission should consider allowing an individual or individuals to effectively act as a family office without requiring that the family office create any corporate entity at all. For smaller family offices that seek to operate through a single individual instead of through a corporate vehicle this will provided needed flexibility.

The Commission also should ensure that its rule allows for individual family members who participate in the operation of the family office to act on behalf of family clients of the family office through a power of attorney, recognizing the patchwork of varying arrangements that arise in the family office context. If the Commission chooses not to allow this power permanently, it should either (i) grandfather agreements already made or (ii) allow these powers temporarily for a period sufficient for family offices to amend agreements in order to be in compliance with the rule. Without allowing either (i) or (ii) above, the rule could severely disrupt family offices that currently rely on one or more individuals acting through a power of attorney or similar appointment.

3. Multi-Family Offices

In addition to the changes we have proposed to the Proposed Rule that would alter the definition of "founder" to more accurately reflect the realities of how most family offices currently function, we believe the Commission should consider allowing multiple related families to pool their resources together as a multi-family office. As long as there is a family relationship between the persons who own and control the separate portions of the multi-family office (*e.g.*, that the members of the offices are cousins), disputes between the members will be family disputes that would be most effectively addressed privately. Therefore allowing multi-family offices to operate as a family office will not lead to the dangers that the Advisers Act intends to remedy.

Allowing multi-family offices to operate as a family office will lead to efficiencies in operation for smaller family offices, minimizing the level of resources expended on overhead costs and transaction costs. Multi-family offices operating as a family office also will result in the families having greater bargaining power with service providers and better access to investments.

The Commission rightfully identifies the need to distinguish between legitimate multi-family offices and commercial investment advisers that ought to be subject to the Advisers Act. We agree that if multi-family family offices are allowed, the rule should distinguish between situations in which related families combine for efficiencies and situations in which managers evade registration under the Advisers Act by advising families only. The Commission could create some black-and-white cutoff for closeness of familial relationships that could include multiple families whose wealth derives from the same founder. The Commission also could prevent third-party advisers from soliciting multiple families to operate as one family office.

We also request that the Commission provide guidance in the final rule release on the extent to which multiple non-related families that choose to pool administrative resources will be integrated for purposes of determining whether they qualify as separate family offices under the rules, as well as to extent to which a family office and a related commercial advisory business will be integrated.

4. Former Family Members

The Commission should adopt its Proposed Rule allowing former family members to maintain investments in a family office but not to make additional investments in a family office. As is the case with involuntary transfers, people are unlikely to use the inclusion of former family members in a family office as a means of evading registration under the Advisers Act. Such gamesmanship would require, for example, parties to enter into a marriage with the intent of divorcing for the purpose of allowing a non-family member to participate in a family office. Such unlikely scenarios are outweighed by the benefits of allowing former family members to maintain their current investments in family offices.

5. Transfers and Involuntary Transfers

Certain transfers and involuntary transfers of family office assets should be allowed without jeopardizing an office's qualification as a family office. Any non-family client who acquires an interest in a family office vehicle by gift, bequest or pursuant to an agreement relating to a legal separation or divorce, should be allowed to maintain such interest without jeopardizing the status of the family office vehicle as a family client. Rather than a required transition period in these circumstances, the family office should be given the discretion as to whether it is prudent to transition, to the extent possible. Allowing those that acquire holdings by transfer of these types to maintain the assets in, but not add additional assets to, a family office, is a preferable solution. This should include the reinvestment of dividends or distributions that result from the earnings on the assets of these transfers, as these earnings do not constitute additional assets but rather the offshoots of the original assets. To provide otherwise may distort the investment decisions of a family office toward assets that do not offer dividends and distributions. This also would be consistent with how the Commission proposes to treat other non-family members that have been allowed to participate in family offices, namely key employees and former family members. Additionally, this would prevent the abrupt liquidation of some assets out of a fear that the family office may lose its family office status. These types of liquidations would be likely to occur at a discount from actual value and could also harm family clients.

An estate of a person who, prior to his or her death, was a family client should remain a family client until the complete and orderly disposition of the assets of the estate is concluded. Estate plans commonly include pecuniary bequests to distant relatives, friends, caretakers and other advisers and to charities. Such bequests have legitimate purposes and should be permitted without jeopardizing family client status. As a result, after the death of a family member or key employee, family office assets may become partially owned by non-family clients. However, the proposed four month transition period is not sufficient to sort out which assets belong to whom given common terms in wills and the laws governing wills and estates. Wills commonly result in contest periods during which beneficiaries settle disputes over who is entitled to property. These contests often take longer than four months to resolve. Credit claims may also arise without resolution for more than four months. In larger estates, it is common that bequests may not be funded until after the estate tax returns are accepted, or at least filed. A family office's exclusion from the Advisers Act should not be jeopardized based on the length of a will contest, a credit claim, or the time it takes for an estate to file a tax return. The rule also should contemplate transfers of illiquid investments. An orderly liquidation of some assets takes longer than four months to effect. Therefore, a longer transition period is necessary to avoid these unintended consequences. We urge the Commission not to set an arbitrary deadline.

The Proposed Rule understandably seeks to define family offices in a way that precludes investment advisers from shoe-horning non-family members into an entity set up as a family office in order to avoid registration under the Advisers Act. However, allowing beneficiaries of these types of "involuntary" transfers to maintain the assets in a family office will not lead to this shoe-horning that the Commission seeks to avoid. The events that give rise to an involuntary transfer are inherently unpredictable. As such, the likelihood of a member of a family office planning an involuntary transfer to a person or entity that does not qualify as a family member in order to avoid any Advisers Act implications is minimal and outweighed by the above-referenced benefits of allowing assets of involuntary transfers to remain in a family office.

6. Other Issues

The Commission should allow non-key employees who acquire assets in a family office by way of discretionary compensation or gift from a family client to continue to participate in a family office. As is the case with the qualified purchaser standard, when an individual acquires assets by way of a gift, bequest or other such transfer, there is no investment decision being made by the individual. Here, the individual has not engaged the family office as an investment adviser.

Rather, the person simply holds assets of an investment decision previously made. Therefore, the situation falls outside of the scope of the problems the Advisers Act seeks to remedy.

The Commission also should allow a family office to grant direct minority and/or non-voting interests in the family office to key employees as gifts or discretionary compensation. Such minority and/or non-voting interests will assist the family office in attracting and retaining talented investment professionals. These interests would more closely align the incentives of the family members with the incentives of the key employees.

We agree with the estate planning flexibility provided by the fact that the proposal does not prohibit family offices from being operated with the intent of generating a profit. A family office may have a legitimate interest in building up capital reserves to meet important long-term or future needs. Without this flexibility to meet estate planning concerns, a family office will face uncertainty as to whether it can build up reserves for these long-term or future needs without jeopardizing its exclusion from the Advisers Act. Funding for prudent long-term concerns could be shortchanged, with excess resources being allocated toward less prudent short-term concerns; additionally, the family office may feel compelled to forgo certain investment opportunities for no reason other than to avoid any doubt as to its family office status. Furthermore, these decisions as to allocation of resources to current expenses versus a build up of capital for the future are exactly the types of decisions best addressed by the family internally.

Sincerely,

Michele Ilene Ruiz

Michele Ilene Ruiz

MIR:ds