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November 18, 2010

Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090
Attention: Ms. Elizabeth M. Murphy
Secretary

Re: **File No. S7-25-10**
Release No. IA-3098
Family Offices

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities (the "Committee") of the Section of Business Law of the American Bar Association (the "ABA") and the Section of Real Property, Trust and Estate Law of the ABA (the "RPTE Section") in response to the request for comments by the Securities and Exchange Commission (the "Commission") in its release referenced above (the "Proposing Release").

The comments expressed in this letter represent the views of the Committee and the RPTE Section only and have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, this letter does not represent the official position of the ABA Section of Business Law.

The comments were principally prepared by a working group comprised primarily of members of the Non-Tax Estate Planning Considerations Group of the RPTE Section. The working group was chaired by Laura M. Twomey and Mary Pokojny O'Reilly. Principal drafting responsibility was exercised by Rana H. Salti and Lenny W. Thebarge, Jr., and significant contributions were made by Laura M. Twomey, Mary Pokojny O'Reilly, I. Mark Cohen, Ryan M. Harding, Joanna M. Kleinhaus, Scott E. Ludwig, Elena Marty-Nelson, D. Scott Robinson, Thomas M. Sheehan, Michael D. Whitty and Lynn Wintriss. The comments were reviewed by Carlyn S. McCaffrey on behalf of the RPTE Section's Committee on Governmental Submissions and by the RPTE Section Executive Committee.

Although the attorneys who participated in preparing these comments on behalf of the RPTE Section have clients who may be affected by the legal issues addressed herein, no such member (or firm or organization to which any such member belongs) has been engaged by a client to make a submission with respect to, or otherwise influence the development or outcome of, the specific subject matter of these comments.

EXECUTIVE SUMMARY

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). The Act will repeal, effective July 21, 2010, the private adviser exemption (also known as the 15-client exemption) contained in section 203(b)(3) of the Investment Advisers Act of 1940 (the "Advisers Act"), upon which many family offices rely to avoid registration with the Securities and Exchange Commission (the "Commission"). The Act will create a new exemption under which family offices would not be treated as "investment advisers" for purposes of the Advisers Act and instructed the Commission to define the term "family office." On October 12, 2010, the Commission issued a proposed rule defining "family offices" and requested comments on the proposed rule (SEC Release No. IA-3098; File No. S7-25-10, the "Release"). These comments set out our recommendations for the definition of "family offices."

COMMENTS

I. Introduction

The Senate Report cited in the Release states that "family offices are not investment advisers intended to be subject to registration under the Advisers Act" and that "the Advisers Act is not designed to regulate the interactions of family members, and registration would unnecessarily intrude on the privacy of the family involved."

We strongly support the Commission's efforts to provide clarity to the definition of family offices that are excluded from the scope of the Advisers Act. Although we agree with many aspects of the proposed rule, we respectfully recommend that the scope of the proposed family office exclusion be broadened as discussed below.

II. Family Office Structure and Activities

A. Expansion of Definition of "Family Members"

We support the Commission's proposed inclusion of adopted children, stepchildren and spousal equivalents within the definition of "family members" and agree with the Commission's proposed definition of "spousal equivalents." In addition, we recommend including foster children and children who are lawfully placed with a person for legal adoption by that person, as does the definition of "family" included in the rule governing permissive shareholders of Subchapter S corporations (IRC § 1361(c)(1)(C))[1].

Although family offices are often founded by or for the benefit of the individual that created a family's wealth, that is not always the case. For this reason, we believe that the proposed rule's definitions of a "family member" and "founders" are under-inclusive. For

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1 References in these comments to "IRC" refer to the Internal Revenue Code of 1986, as amended.

example, a family office founded by Mother would not qualify as a family office under the proposed rule if it had as a client a trust created by Mother's grandmother for the benefit of all of her grandchildren (because the trust would be for the benefit of individuals—Mother's cousins—who are not included in the definition of family members).

Therefore, we recommend that the definition of "family member" in proposed rule §275.202(a)(11)(G)-1(d)(3)(ii) be broadened to include the founders' stepparents, stepgrandparents, and grandparents and the spouses and spousal equivalents of all of these individuals. We recommend a conforming change to (d)(3)(iii), allowing for siblings and lineal descendants of such stepparents, stepgrandparents, and grandparents to be included as "family members." This change can be accomplished by replacing the term "founders" in (d)(3)(iii) with the phrase "family members listed in (i) and (ii)." Revised (d)(3)(iii) then would read: "the siblings of the family members listed in (i) and (ii) and such siblings' spouses or spousal equivalents and his or her lineal descendants (including by adoption) and such lineal descendants' spouses or spousal equivalents."

Even if the definition of family members is expanded as suggested above, the concept of founders leads to inconsistent results, as illustrated in the following examples:

(1) Mother establishes a family office during her life for the benefit of her and her descendants. The family office qualifies under the proposed rule. Even after Mother's death, the family office, which now functions solely for the benefit of Mother's descendants, still qualifies under the proposed rule.

(2) Mother dies before establishing a family office. After her death, her three daughters want to establish a family office. It is unclear under the proposed rule whether there can be more than one founder (and spouse or spousal equivalent). If not, the three daughters will have to establish separate family offices whereas if their mother had established a family office while she was alive, the siblings could have shared a family office after her death.

As these examples illustrate, the definition of "founder" should be clarified to enable siblings to share a family office regardless of whether the office was established before or after their common ancestor's death.

Alternatively, instead of revising the definitions of "family members" and "founders" as described above, the concept of founders could be eliminated in the rule, and instead, the rule could allow families to choose a common ancestor (who may be deceased) as the designated relative of the family, and define family members with reference to degrees of lineal and collateral kinship from the designated relative, including the spouses and spousal equivalents of all of these individuals. If the Commission is concerned that a very remote common ancestor may be chosen, the rule could include a limitation regarding the number of prior generations that may be chosen, like the rules governing Subchapter S corporations in which a common ancestor may be chosen to define members of a family provided that the individual chosen may not be more than six generations removed from the youngest generation of shareholders who would be members of the family (IRC § 1361(c)(1)(B)).

For example, the term "Family Member" could be defined as "all individuals who share a common ancestor (including those who share such ancestor by adoption and including those who are stepchildren of any such individual) who is not more than nine generations removed from the youngest generation of such individuals, the spouses and spousal equivalents of all such individuals."

B. Allowing Additional Time to Address Involuntary Transfers

We recognize the Commission's concern in allowing a family office to continue to advise a party who has received assets in an involuntary transfer. However, many family offices manage private equity and other illiquid investments which do not allow investors to redeem their interests. For these reasons, family offices should be allowed a reasonable period of time to transfer assets to non-clients without jeopardizing their exemption from registration. We do not believe that this approach would jeopardize the Commission's objectives because family offices generally would prefer to transfer assets to which non-family members are entitled as soon as possible for liability and other practical reasons. Because it is difficult to establish a bright-line time period, we recommend that the proposed rule be modified to require that transfers of assets from family offices to non-family clients be effected as soon as practicable in light of the facts and circumstances applicable to each particular situation, and a minimum of two years should be presumed to be reasonable.

C. Including Former Family Members

We ask the Commission to reconsider the limitation on the receipt of investment advice by former family members. Following a divorce, for example, a spouse may decide to continue working with a family office, particularly because his or her children may continue to be advised by the family office and may be the beneficiaries of large family trusts for which the family office provides investment advice. In our view, family offices should be permitted to be able to advise former spouses or other former family members, including former stepchildren and former stepgrandchildren, and these former family members should be free to continue receiving investment advice from family offices, all without subjecting the family offices to investment adviser registration. Moreover, requiring a family office to have to make the choice of either (1) limiting its investment advice to a former family member to assets under management at the time he or she became a former family member or (2) lose its family office exemption runs directly counter to the Commission's privacy goal stated in the release of the proposed rule. Accordingly, we suggest eliminating (d)(2)(vi). We further suggest a corresponding change to the definitions section. We suggest moving the language in (d)(4) regarding former family members into the definition of family member. Thus, (d)(4) would become (3)(iv). The definition also should include stepgrandchildren. We believe that blocking access to former stepchildren not only violates the Commission's privacy goal but also runs counter to public policy.

D. Broadening the Inclusion of Family Trusts, Charitable Organizations, and Other Family Entities

We recommend that the Commission expand the definition of "family clients" as it relates to trusts, estates, charitable foundations, charitable organizations, charitable trusts and other family entities. A family office may provide advice to the trustee of a trust which is held for the benefit of all family members, but the trust instrument may include a contingent charitable beneficiary, in the unlikely event that all family members are deceased or under other circumstances. Under the proposed rule, this trust would not qualify as a family client. Similarly, the family office may advise the executor of an estate of a family member. If an estate is not held exclusively for the benefit of family clients, then the family office cannot advise the executor of the estate for more than four months under the proposed rule.

In addition, a family office may advise the managers of a family-owned limited liability company ("LLC"). The LLC may be managed, for example, by four siblings but the siblings may decide to include a tie-breaker provision in which a designated friend of the family or other person would be entitled to vote to break a tie in certain circumstances. Under the proposed rule, this LLC may be deemed to not be "controlled (directly or indirectly) exclusively by… one more family clients," even if the tie-breaking provision is never used. We believe an overly restrictive definition would undermine the reasonable expectations and arrangements of family members and subject the family office to a degree of regulation that the Senate Report cited by the Commission indicates was not within the statutory intent.

For these reasons, we recommend that "family client" mean (i) a family member, (ii) any estate of a family member, (iii) any trust, estate, guardianship, custodianship or other fiduciary arrangement established by, controlled by or primarily for the benefit of any one or more family members, (iv) any corporation, partnership, limited liability company or other business organization controlled by or substantially all of the interests in which are owned, directly or indirectly, by any one or more individuals, estates or entities described in (i), (ii) and (iii), (v) any charitable organization (meaning an organization described in all of Internal Revenue Code Sections 170(c), 2055(a) and 2522(a)) directly or indirectly established or controlled by one or more family members, and (vi) key employees as defined in the proposed rule. We believe that these definitions would reflect the array of family clients that family offices routinely advise and would not inappropriately expand the exclusion for family offices.

E. Key Employees Should Be Included

We strongly support the Commission's proposal to include key employees as "family clients" for purposes of defining those eligible to receive investment advice from and participate in the investment activities of the family office. We agree that the inclusion of these key employees allows family offices to better recruit talent and incentivize employees. We support the Commission's adoption of the "knowledgeable employee standard" of the Advisers Act. Furthermore, we agree that key employees should be able to structure their investments through trusts and other entities.

With respect to the periods after the termination of key employees' service with the family office, we agree that key employees should not be permitted to make additional investments through the family office. We also agree that key employees should not be required to liquidate or transfer investments from the family office to avoid possible adverse tax or investment consequences.

We recommend that the Commission eliminate the twelve-month experience requirement. Although we recognize that a new employee may be included if he or she performed "substantially similar functions or duties for or on behalf of another company," we do not believe that the twelve-month period is necessary in order to achieve the Commission's objectives. In our view, it would only add unnecessary complexity to the arrangements and could serve to dissuade a potential employee from providing service to the family office.

III. Ownership and Control of Family Office

We recommend that the Commission reconsider the proposed rule that a family office be wholly owned and controlled (directly or indirectly) by family members. While many family offices are wholly owned and controlled by family members, others are not. For example, a family office may be owned by a family trust with an independent trustee, or a family office may be owned by a private trust company. In our view, the Commission's objectives are not furthered by excluding those family offices from the registration exemption. As with our proposed definitions above with respect to trusts and other family entities, we recommend that a "family office" be defined as any form of business entity or company (i) established by one or more family clients, (ii) controlled (directly or indirectly) by one or more family clients, or (iii) existing primarily for the benefit of one or more family clients.

IV. Requirement that Family Offices Do Not Hold Themselves Out to the Public as Investment Advisers

We agree that family offices that hold themselves out to the public as investment advisers should not be entitled to rely on the exclusion.

V. Previously Issued Exemptive Orders Should Not be Rescinded

We agree that the Commission should not rescind its previously-issued exemptive orders.

Once again, the Committee and the RPTE Section appreciate the opportunity to submit these comments and we respectfully request that the Commission consider our recommendations. Members of the Committee and the RPTE Section are available to meet and discuss these matters with the Commission and its Staff and to respond to any questions.

Very truly yours,

<u>/s/ Jeffrey W. Rubin</u>
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Chair, Committee on Federal Regulation of Securities

<u>/s/ Alan F. Rothschild, Jr.</u>
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