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November 18, 2010

By Electronic Mail (rule-comments@sec.gov)

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

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

Dear Ms. Murphy:

Thank you for this opportunity to comment on Proposed Rule 202(a)(11)(G)-1 (the "Proposed Rule") that was released by the Securities and Exchange Commission (the "Commission") on October 12, 2010 (the "Release").[1] By way of background, our firm has had the opportunity since its formation on January 1, 2000, to have represented more than 100 distinct single family offices that serve multiple generations of family members and their affiliated entities. The majority of these families will be adversely impacted by the narrow definition of "family office" set forth in the Proposed Rule. Few, if any, of the approximately 40 family offices with which we are currently working would qualify for the exemption without materially limiting the "family clients" that they currently serve.

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[1] Family Offices, Investment Advisers Act Release No. 3098 (Oct. 12, 2010).

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[2] made substantial changes to the Investment Advisers Act of 1940 (the "Advisers Act") including eliminating the "fewer than 15 clients exemption" now found in section 203(b)(3) of the Advisers Act. As stated in the Senate Committee Report, the primary purpose for eliminating the "fewer than 15 clients exemption" was to require advisers of private funds (*i.e.*, hedge funds) to register under the Advisers Act.[3]

Yet, Congress specifically acknowledged that in doing so an *unintended* consequence of repealing the 15 clients exemption would be to force family offices that relied on the exemption to register under the Advisers Act[4] unless another exemption was provided for them. Congress also plainly stated that "family offices are not investment advisers intended to be subject to registration under the Advisers Act."[5] So, to prevent the unintended consequence of mass registration and supervision by the Commission of family offices and to maintain the *status quo* for families as Congress intended, the Dodd-Frank Act sets forth and directs the Commission to define a new exclusion under which the family offices referenced by Congress will be exempt from registration as investment advisers under the Advisers Act.[6] Specifically, Section 409 of the Dodd-Frank Act directs the Commission to adopt a definition of a "family office" that:

(1) is consistent with previous exemptive policy of the Commission, as reflected in exemptive orders for family offices in effect on the date of enactment of the Act, and recognizes the provisions in paragraph (3);

(2) recognizes the range of organizational, management, and employment structures and arrangements employed by family offices; and

(3) [addresses grandfathering issues].[7]

In its application of this directive, the Commission explains in the Release, "the core policy judgment that formed the basis of the exemptive orders (and which prompted Congressional action) is the lack of need for application of the Advisers Act to typical single

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[2] Pub. L. No. 111-203, 124 Stat. 1376 (2010).
[3] *See* S. CON. REP. NO. 111-176, at 38-39 (2010) ("Senate Committee Report").
[4] We note that a family office could seek an exemptive order from the Commission, but the practical difficulties that would be presented if even a very small minority of family offices sought to *obtain* an exemptive order prior to July 21, 2011, once a final rule was issued would be extraordinary. The Release setting forth the Proposed Rule acknowledged the immense financial burden on families as well, of seeking such orders, estimated to cost on average $200,000. *See* Release, at 28.
[5] Senate Committee Report, note 12 at 75.
[6] *Id.*
[7] Pub. L. No. 111-203, 124 Stat. 1376, 1575 (2010).

family offices."[8] The purpose of the Proposed Rule, then, according to the Commission, is to distinguish among the approximately 2,500 to 3,000 family offices in the United States managing more than $1 trillion in assets (an average of $517 million) that serve "a typical family" from those that "start[] to resemble a commercial adviser."[9] We view the Commission's core policy objective and purpose of the Proposed Rule as sound and consistent with its directive.

The nub of the issue, however, is "What is a typical family office?", and if our experience is representative, then the Proposed Rule does not capture even a majority of typical family offices and therefore fails to meet the Commission's core policy objective or Congressional purpose.

While the Proposed Rule undisputedly describes a single family office that does not resemble a commercial adviser, its stringent and narrow requirements are unduly restrictive. As stated earlier, we know of very few, if any, single family offices that would satisfy the definition of a "family office" set forth in the Proposed Rule.[10] So while these single family offices would fail to qualify as a family office for purposes of the Proposed Rule, they would universally satisfy the stated core policy of the Commission and would not even "start" to resemble a commercial investment adviser.[11] As a result, if the Proposed Rule is not fundamentally modified, the vast majority of the estimated 3,000 single family offices who technically fall outside the definition of a "family office", who do not resemble a commercial adviser, and who currently are excused from registering under the "fewer than 15 clients exemption" will be forced to register under the Advisers Act as of July 21, 2011. We believe that this is the exact unintended consequence Congress directed the Commission to avoid. Thus, the Proposed Rule fails its directive because it does not describe an entity recognizably embracing "typical single family offices".

What is needed is a definition that truly describes a typical single family office and that also satisfies the Commission's core policy objective that such office not begin to resemble a commercial investment adviser. In order to accomplish this, we need to keep in mind that while single family offices all share the same general purpose (to serve the single

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[8] Release, at 8.
[9] *Id.*
[10] In general, while we are confident that other comment letters will address specific problems with a number of defined terms found in the Proposed Rule including "founders", "family members", and "family clients" and the requirement that family members own *and* control all interests in a family office, we note in particular the requirement that a trust *solely* benefit a family client would exclude almost every trust that if well-drafted would provide for contingent non-family beneficiaries.
[11] In fact, we believe that the current Proposed Rule is so narrow that, as acknowledged in the Proposed Rule, many (if not all) of the family offices that obtained exemptive orders in the past would fail to meet all aspects of the definition set forth in the Proposed Rule.

family and most definitely not the general public), their legal, family governance and operational structures are anything but uniform. No two families or their respective family offices are likely to be identical in structure. Nor will the scope of family members be the same from family office to family office. Yet, despite these technical differences, the vast majority of "typical" single family offices fall squarely within the Commission's articulated core policy objective.[12]

For example, a family office owned by a family trust (the non-family member trustee of which is directed by family members) should not be disqualified while a family office owned and controlled directly by a patriarch or matriarch of a family is qualified. A family office with a deceased founder or with multiple founders should not be disadvantaged compared to a family with a sole, living founder. Family offices that allow executives to receive investment advice as a perk for serving as a trusted family employee should qualify in the same manner as a family office that allows an executive to invest alongside the family in recognition of the investment advisery skills of the executive. Similarly, family offices that continue to allow a former spouse and her or his children who are half-siblings of a family member to receive ongoing investment advice should not run afoul of the Commission's family office definition. All of the foregoing variations (and many, many similar variations) are found in most typical family offices. Nonetheless, it is difficult to imagine how such variations fundamentally change a family office's core purpose or make a family office begin to resemble a commercial endeavor.

The question of how broadly to define a family office can also be approached from another direction by asking this question: Were a "family office" to be defined more broadly, could a commercial investment adviser really make a business out of operating a "family office"? We think that the answer to this question is "no".

Even if the assets and clients served by an actual typical family office were sufficient to sustain a commercial business plan (and we recognize that most family offices have assets sufficient to support a commercial investment adviser at some level of profitability if they so chose), no one with a commercial business plan would have or would be given the necessary access or control to succeed. Families come together and provide themselves investment advisery and other family office services for their own core purposes, not for the purposes of enriching investment advisers.

Accordingly, no investment adviser with a commercial purpose who had to restrict its business to only the clients of a true typical family office would get the access or control to

[12] This fact is demonstrated by the technical but *de minimus* factual differences found in the exemptive orders and releases previously issued by the Commission.

make a financial success of such a business plan. Among other things such an investment adviser's client base would be 100% concentrated with essentially one client; if he lost that client, he would lose his entire business. As long as the family office definition meets the test of having a clientele that a commercial investment adviser would constantly be at risk of losing entirely at the whim of the family, it will not start to look like a commercial adviser (or at least not a prudent one). We know of no commercial investment adviser in existence that has built their business around a single family office's client base and we therefore believe that no such commercial adviser could restrict its business even a broadly defined single family.

To incorporate the familial variations we referred to above, we believe the Commission should adopt a more flexible definition of a family office. Such a definition would satisfy the Commission's core policy goal while still prohibiting exempt entities from operating a commercial advisery business. This definition should be broad enough to include the typical family office. Fortunately, such an approach has already been accomplished by certain states in the context of state family trust companies. States such as Nevada, New Hampshire, North Carolina and Texas (there are several others) allow families to form family trust companies as opposed to commercial or public trust companies. The most recent example is Nevada's Family Trust Companies Act,[13] which was adopted in 2009 and had the benefit of being able to incorporate the best ideas from previously adopted statutes of other states.

In general, we recommend that the Commission adopt a definition for "family offices" similar to the definition adopted by these states in authorizing "family trust companies". These statutes permit a family trust company to serve "family members" as defined by the states' applicable trust company laws. These acts were written to address the exact challenge posed to the Commission by the Dodd-Frank Act: how to describe a family office in such a way as to distinguish it from a commercial endeavor, in this case a retail or institutional trust company. We believe that if the Commission adopted a definition of "family member" manner similar to Nevada's Family Trust Companies Act,[14] it would satisfy the Commission's

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[13] NEV. REV. STAT. 55.669A.010-320 (2010).

[14] Nevada family trust company law defines "family member" as the following:

"Family member" defined.

1. "Family member" includes, without limitation, the designated relative and:

(a) Any person within the tenth degree of lineal kinship of the designated relative;

(b) Any person within the ninth degree of collateral kinship to the designated relative;

(c) Any nonfamily member who is an individual beneficiary under a will or trust created by a family member specified in paragraph (a) or (b), including the spouse and issue of that person;

(d) The spouse and any former spouse of the designated relative or of any person qualifying as a family member pursuant to paragraph (a) or (b);

core goal while at the same time encompassing the vast majority of typical single family offices. We recommend Nevada's definition of family member because it represents the most well-informed effort of any state to date to capture the vast majority of the clientele of a typical family office as opposed to the clientele of a commercial trust company. It uses terminology that is familiar to the family office and trust domains and is consistent with investment advisery concepts. As such it provides clarity to families and regulators, and it would be the least likely to "trip up" a typical family office and require registration or an exemptive order petition. At the same time, we see no risk of permitting or encouraging commercial activity even with this broader definition. In addition, we encourage the Commission to incorporate any innovative ideas, such as its definition of spousal equivalents found in the Proposed Rule, which would indeed be improvements to the state family trust company statutes.

Note that the Nevada statute[15], like the other state trust company statutes mentioned, uses in place of a "founder" the concept of a "designated relative" that the family is free to identify. In the traditional sense, all family members are bound together by their

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(e) A person who is a relative of a spouse or former spouse specified in paragraph (c) or (d) who is within the fifth degree of lineal kinship of the spouse or former spouse;

(f) A family affiliate and the officers, managers and directors of that family affiliate and their immediate families;

(g) An inter vivos or testamentary trust established by a family member either individually or jointly with a spouse or third party and any trustee, advisor or other person assisting with administration of that trust;

(h) An inter vivos or testamentary trust established by a person who is not a family member if noncharitable beneficiaries of that trust include family members;

(i) The estate of a family member;

(j) The estate of a nonfamily member if the noncharitable beneficiaries of that estate include family members; and

(k) A charitable foundation, a charitable trust or charitable entity of which a family member is an organizer, incorporator, officer, member of the governing board, trustee, major donor or noncharitable beneficiary and the officers, directors, individual trustees and managers of that foundation, trust or entity and their immediate families.

2. For the purposes of this section:

(a) A family member is not a member of the public;

(b) A legally adopted person must be treated as a natural child of the adoptive parents;

(c) A stepchild must be treated as a natural child of the family member who is or was the stepparent of that child;

(d) Children of a spouse of a family member must be treated as a natural child of that family member; and

(e) Degrees are calculated by adding the number of steps from the designated relative through each person to the family member either directly, in the case of lineal kinship, or through the common ancestor, in the case of collateral kinship.

3. As used in this section:

(a) "Collateral kinship" means a relationship that is not lineal, but stems from a common ancestor.

(b) "Lineal kinship" means a family member who is in the direct line of ascent or descent from the designated relative.

NEV. REV. STAT. 55.669A.070 (2010).

[15] *Id.*

relationships to one another and as time goes by the concept of the "family" necessarily evolves. In the context of a family trust company, family members and family clients are ultimately defined by their relationship to the "designated relative", who may be living or deceased. As time goes on, the family has the opportunity to change the designated relative but because all clients are defined by their lineal or collateral kinship to the designated relative, changing the designated relative has the effect of adding some family members while eliminating others from the definition of "family member". The ability of a family trust company to evolve with the family is also essential to a family office. Thus, we strongly urge the Commission to adopt a similar approach. Nevada contemplates 10 degrees of lineal kinship and 9 degrees of collateral kinship.[16] Other states' family trust company laws embrace fewer degrees. Nevada's definition was informed by the negative experience in some of the other states, notably Texas, whose narrower definitions forced many families to forego a "family trust company" in that state rather than lopping off service by the family office to some branches of the family tree that the family office had historically been serving.

While we believe defining a "family member" (as these state statutes do) serves a distinct function to insure that an office is a "typical family office", we do not believe that it is necessary to restrict the ownership and control of a family office to family members (as these state statutes do not do). As noted by Congress, typical single family offices have a myriad of ownership and governance structures that are tailored to each family. Despite the differences, these structures all share the overriding common purpose to allow a family to manage and control its own wealth, even when the family office entity is owned or controlled by one or more non-family members, as is sometimes the case. Moreover, we again do not see a true commercial adviser-like opportunity or "loophole" that would be available to non-family members if ownership is not so narrowly restricted. We also do not see an opportunity for private funds to fit within this loophole.

We also note that the requirement that a family office not hold itself out to the public as an investment adviser (which we believe should be retained in any final rule) should be sufficient authority for the Commission to disregard any arrangement that is more like a commercial endeavor designed with the purpose of avoiding registration.[17] We feel the Commission would be better served utilizing this approach rather than unduly restricting the definition of a family office. In fact, we know of no non-family member or group of non-family members who has utilized or attempted to utilize a state family trust company structure in lieu of a commercial venture to serve as a fiduciary or investment adviser to a single

[16] *Id.*
[17] Release, at 37.

family.[18] Nor do we see any opportunity for a family to do so and still qualify as a family trust company under the Nevada law.

In sum, we believe the Proposed Rule as drafted will require the vast majority of the estimated 3,000 single family offices who currently operate under the "fewer than 15 clients exemption" to register under the Advisers Act. Instead, we recommend that the Commission adopt an approach similar to the successful approach found in one or more state family trust company statutes. We welcome any questions that you may have regarding this approach or any related issues.

Sincerely,

John P.C. Duncan
(facsimile signature)

[18] If an ownership or control test is retained in the final rule issued by the Commission, we encourage a definition that at most would require family members to own *or* control, directly or indirectly, no more than a majority of the ownership interest in the family office. The control test should be satisfied if a family member has the power to direct a trustee of a trust to elect the directors, managers or other similar executives of the family office.