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November 16, 2010

Via Electronic Mail

Ms. Elizabeth M. Murphy, 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; 17 CFR 275.202(a)(11)(G)-1 [Release No. IA-3098; File No. S7-25-10, RIN 3235-AK66, Family Offices]

Dear Ms. Murphy:

The American Institute of Certified Public Accountants ("AICPA") has prepared the following comments on Proposed Rule 202(a)(11)(G) (the "Proposed Rule"), issued on October 12, 2010 by the Securities and Exchange Commission (the "Commission"). The Proposed Rule seeks to clarify the definition of *family offices* that are excluded from the definition of an investment adviser and are not subject to registration or regulation under the Investment Advisers Act of 1940 (the "Advisers Act").

The AICPA is the national professional association of CPAs with more than 360,000 members, including CPAs in business and industry, public practice, government, and education; student affiliates; and international associates. Our members provide audit, tax, retirement consulting, plan administration, and financial planning services. Many of our members advise and work very closely with single family offices of various sizes and with many different structures. It is from this perspective that we provide our comments and recommendations.

As objective and trusted advisers, CPAs play a critical role in improving the enforcement of the Advisers Act and providing policymakers with the benefit of our experience. Our comments below focus on various definitions and questions posed in the Proposed Rule and identify specific practical recommendations that we believe best serve the interests of the investing public, while taking into account the objective of the Commission to appropriately limit the scope of the family office exemption to traditional single family offices.

Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203, H.R. 4173) (the "Dodd-Frank Act") was signed into law on July 21, 2010. Section 403 of the Dodd-Frank Act eliminated the exemption from registration for investment advisers with fewer than 15 clients in the preceding 12 months, as previously provided for in Section 203(b)(3) of the Adviser's Act, effective beginning July 21, 2011. However, Section 409(a) of the Dodd Frank Act also provided for a new exemption from registration for "family offices" under Section 202(a)(11)(G) of the Advisers Act. Section 409(b) of the Dodd-Frank Act required the Commission to define the term *family office* by rule, regulation, or order. On October 12, 2010, the Commission issued Investment Advisers Act Release No. 3098 (the "Release") setting forth an exemption for family offices and requesting comments on and responses to questions in the Proposed Rule.

General Comment

The AICPA commends the Commission for its thoughtful approach to define family offices, and generally supports the approach set forth in the Proposed Rule. The Proposed Rule provides, in general, that a family office is a company that (i) is wholly owned and controlled by family members, (ii) has no clients other than family clients, and (iii) does not hold itself out to the public as an investment adviser. We appreciate the opportunity to respond to the questions in the Proposed Rule and offer our specific comments and suggestions for possible modifications and clarifications to the Proposed Rule.

Family Office Structure and Scope of Activities

1. Family Clients

Although we support the Commission's premise that in order to be excluded from registration, a family office must not have any investment advisory clients other than *family clients*, we strongly believe that the definition of family clients must be inclusive enough to encompass all of the clients and arrangements that are typically present in a single family office, yet not so broad as to subvert the intent of the Commission to limit the exemption to single family offices. Our comments on family clients focus on the various sub-categories identified by the Commission in their Release, including *founder*; *family members*; *former family members*; *family trusts, charitable organizations, and other family entities*; *key employees*; and *involuntary transfers*.

Founder

The proposed definition of family members is determined by the degree of the relationship a person has to the *founder* of the family office. Consequently, the utility and appropriateness of the exemption for family offices depends heavily upon the degree to which the definition, or use, of the term founder reflects the purposes of the Advisers Act as amended by the Dodd-Frank Act and the degree to which it accommodates the most common organizational structures of family offices.

Proposed Regulation Section 275.202(a)(11)(G)-1(d)(5) provides that the term *founder* 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.

It is not clear from the proposed definition whether a founder needs to be an equity owner in the family office in order to be a person for whose benefit the office was established, or whether the definition of a founder includes a person who is one of the initial individuals benefiting from the services of the family office. Further, the proposed definition assumes that a family office typically has a single founder, or a married couple as founding parties. While this may be the case in instances where the originator of a family's wealth establishes the family office, there are many instances where a family office is not established until several generations after the death of the creator of the enterprise that generated the wealth. In such cases, there may be multiple founders who may all be descendants of the original creator of the family's wealth, but not necessarily siblings of each other.

In its definition of *founders,* the Proposed Rule refers to "*the* natural person and his or her spouse" for whose benefit the family office was established (emphasis added). We recommend that the term founders should refer to all those individuals (and spouses) who initially benefit from the establishment of the family office (i.e., definition of founders should accommodate multiple founders and spouses and not require an equity investment in order to qualify as one of the founders). We further recommend, in order to exclude the exemption of multi-

family offices under this rule, the Proposed Rule require that all of the founders (except founders who are also key employees) of a family office must be descendents or spouses of descendents of a common ancestor who is no more than four generations removed from the oldest founder (i.e., all are descendents of a great-great-grandparent of the oldest founder). This recommendation seeks to accommodate situations in which the initial creator of the family wealth has predeceased the formation of the family office and to ensure an adequate familial relationship between the founding individuals who will be served by the family office.

There also may be instances where a key employee is one of the individuals who initially benefit from the establishment of the family office and, therefore, would otherwise be considered a founder under the Commission's proposed definition of founder. Accordingly, we recommend that a key employee should be excluded from the group of founders for purposes of determining whether or not a family member has sufficient familial relationship to a founder to meet the definition of family member as proposed above (in turn, making those family members permissible family clients).

Family Members

The Commission's proposed definition of *family member* includes the founder and his or her current (and any subsequent) spouse or spousal equivalents, the founder's parents, the founder's lineal descendants (including by adoption and stepchildren), and such lineal descendants' spouses or spousal equivalents. It also includes the founder's siblings, the siblings' spouse or spousal equivalents, their lineal descendants (including by adoption and stepchildren) and such lineal descendants' spouses or spousal equivalents.

The AICPA supports the inclusion of the above-mentioned individuals in the definition of family member. We also support the inclusion of individuals under guardianship of a family member. In addition, we recommend that grandparents (of the founder) be included in the definition of family member. We also recommend that widows/widowers of a family member specifically be named in the definition of family member.

Former Family Members

We support the Commission's proposal to allow former family members (i.e., former spouses and spousal equivalents, stepchildren, etc.) to retain their investments made through the family office. We strongly urge the Commission to reconsider the proposed restriction on making any "new" investments through the family office. For example, if a divorced spouse is an existing client of the family office and wishes to continue the advisory relationship, we do not believe that there should be restrictions particular to that investor concerning their ongoing relationship with their investment adviser. Such a provision appears to create additional and unnecessary administrative complications, such as the definition of a new investment versus an existing investment, the need to establish carve-outs for investments with unfunded contractual obligations, and related concerns. We believe that the existence of former family members as continuing family office clients in and of itself should not be a determining factor as to whether or not a family office should be required to register with the Commission. As such, the AICPA proposes that the Commission reconsider any restrictions placed on former family members regarding making new investments through the family office.

Family Trusts, Charitable Organizations and Other Family Entities

The Proposed Rule includes as family clients: (i) any charitable foundation, charitable organization, or charitable trust established and funded exclusively by one or more family members, (ii) any trust or estate existing for the sole benefit of one or more family clients, and (iii) any company, including a pooled investment

vehicle, that is wholly owned and controlled, directly or indirectly, by one or more family clients and operated for the sole benefit of family clients.

We support the inclusion of these entities as family clients; however, more flexible and inclusive definitions are necessary to accommodate many common arrangements typically established and utilized by high net worth families. There are numerous such arrangements. A few examples include: (i) a family's private foundation that has accepted some limited donations from non-family members, (ii) a family-owned business with a non-family client minority investor, (iii) a family trust with a public charity as a current or contingent beneficiary, and (iv) an estate with non-family client beneficiaries.

As such, we propose a provision that includes as a family client any entities and organizations that are (1) majority owned or established, directly or indirectly, by family clients, or (2) majority controlled, directly or indirectly, by family clients. Majority is defined as more than 50 percent.

Alternatively, the Commission can address non-family client investment through a de minimis provision, such that the existence of some level of non-family client investment will not result in the arrangement failing to satisfy the definitional requirement of a family client. Such a provision can either limit third party investment to some percentage of the assets invested (for instance, 5 percent), limit the number of non-family client investors to a set number (for instance, 10), or both. This approach offers a practical way to add needed flexibility without undue complication. An absolute prohibition on any non family client investment does not accurately reflect how high net worth families govern their affairs.

Key Employees

The Proposed Rule permits the family office to provide investment advice to *key employees*. A key employee is defined as any natural person who is (i) an executive officer, director, trustee, general partner, or person serving a similar capacity of the family office, or (ii) any other employee of the family office (other than an employee performing solely clerical, secretarial, or administrative functions), who in connection with his or her regular duties, has participated in investment activities of the family office, or similar functions or duties for or on behalf of another company, for at least twelve months.

We agree with the inclusion of certain key employees in the definition of family clients and support allowing key employees to receive investment advice from, and participate in investment opportunities provided by, the family office. We recommend that the "persons serving a similar capacity of the family office" be construed broadly to include board members and other long-term advisors that are often found in family office settings. In addition, we support the Commission's proposal to permit key employees to participate in co-investment opportunities as individuals, as well as through trusts and other entities.

We also agree that key employees should be allowed to continue to hold such investments through the family office after their employment has ended, but be prevented from making any additional investments through the family office. We recommend that the Commission provide further guidance on what constitutes "additional investments."

The AICPA does not support the requirement that a key employee be restricted for a twelve-month probationary period before he or she is permitted to make an investment with the family office. The Commission commented in its Release that key employee co-investment opportunities are often utilized as an incentive to attract top investment professionals to work at the family office. Such a time restriction may unnecessarily hinder the

family office from recruiting top talent to work at the family office, and; therefore, we propose that this time restriction be eliminated.

Involuntary Transfers

The Commission recognizes that there are many situations when assets under management of the family office are transferred involuntarily. The Proposed Rule allows the family office to continue to provide investment advice if the transfer is to a family client. If the transfer is to a non-family client, there is a four month grace period to advise such a client without violating the Proposed Rule.

The example provided in the Release identifies a situation where a decedent left assets in a family office-advised private fund to a charity that did not qualify as a family client, and thus the family office was permitted to advise such a client for four months *following the transfer of assets resulting from the involuntary event* (emphasis added). Additional clarification is needed as to what constitutes a *transfer* (whether it infers a change in legal title) and when such transfer occurs (whether it equates to the date of re-titling of the assets).

Continuing with the example provided in the Release, in an estate of a high net worth family member, such a bequest may first involve re-titling the assets from the decedent's name to the name of the decedent's estate under the control of a personal representative or executor. Then after a period of administration, which most likely would run well in excess of a four month grace period (in fact, when there is significant litigation, illiquidity, or the estate tax return is under review by the Internal Revenue Service, the period of administration can last many years), the assets may again be re-titled from the decedent's estate to the charity. Does an involuntary transfer occur upon the first re-titling of the assets (from the decedent to the estate)? If so, would the existence of a non-family client beneficiary of the estate (such as a public charity) disqualify the estate as a family client? We propose that a more flexible definition of family client, as discussed above, will alleviate many of the family-specific issues that will arise when assets are involuntarily transferred.

We support the Commission's proposal to provide a grace period for involuntary transfers to non-family clients. However, we believe that a four-month grace period is insufficient time for a family office to orderly transition the client's assets to another investment adviser, seek exemptive relief, or otherwise restructure its activities to comply with the Advisers Act, particularly in situations where the assets are not readily marketable or easily transferrable. Aside from the potentially adverse tax consequences of a forced disposition, the transferee may be subject to legal, economic and financial restrictions as well.

Consequently, we recommend that all involuntary transfers to non-family clients be allowed a grace period of at least twelve months from the transfer of legal title resulting from the involuntary event.

2. Ownership and Control

The Proposed Rule requires that a family office be wholly owned and controlled, either directly or indirectly, by family members. We understand the Commission's concern, which is to assure that the family is in a position to protect its own interests; however, an absolute prohibition against any non-family member ownership is overly restrictive and inconsistent with the way many traditional single family offices are structured, which is to align the interests of the family with those of their key employees.

For example, it is not uncommon in practice for a family office employee to have a direct ownership interest in the family office. The Release recognizes that key employees are often allowed to participate in co-investment opportunities with the family as an incentive for employment or to provide motivation for positive investment

results. In a similar fashion, many family offices permit employee ownership as a long-term retention and incentive tool. As such, we recommend that key employees be allowed to hold a non-controlling interest in the family office entity.

In addition, it is not uncommon for a trust or a closely-held family entity to have an ownership interest in the family office. For example, the family office may include an irrevocable trust as a co-owner, or the office may be a wholly-owned subsidiary of a closely-held family entity. Although many of these arrangements may be covered under "wholly owned and controlled…indirectly" as provided for in the Proposed Rule, any non-family beneficial interest or minority ownership interest in the family office ownership structure will fail to satisfy this proposed requirement.

The Dodd-Frank Act requires that in defining family office, the Commission "recognize the range of organizational, management, and employment structures and arrangements employed by family offices." In light of this charge, we propose that the Proposed Rule for family offices be modified to read: "(1) majority ownership by family members, directly or indirectly or (2) majority control by family members, directly or indirectly." Majority is defined as more than 50 percent.

The AICPA supports the Commission's position to not propose a specific condition regarding whether the family office generates a profit. We believe that the matter of whether a family manages the family office with (or without) a profit motive is a financial decision that should remain solely with the family. Although the Release indicates that most family offices that previously obtained an exemptive order from the Commission have represented that they did not operate for the purpose of generating a profit, we believe that a profit motive is not a distinguishing factor between a family office and a family-run commercial investment advisory business. For example, a family that has permitted employee ownership of the family office as a long-term retention and incentive tool may desire to manage the family office with a profit motive. This employee-owner is then motivated to "keep the costs down" for the family office, which is an important, ongoing concern for nearly every family.

3. Holding Out

The Proposed Rule prohibits a family office from holding itself out to the public as an investment adviser. We support this approach and believe that this is likely the most important condition that the Commission could impose to effectively separate a single family office from a more typical commercial investment advisory business. A single family office, regardless of ownership structure or profit motive, would not be interested in holding itself out to the public as an investment adviser. In contrast, a commercial investment advisory business, family-owned or not, would be interested in holding itself out to the public as an investment adviser as a means to further its business objective.

4. Grandfathering Provisions

We understand that the Dodd-Frank Act mandated the incorporation into the Proposed Rule of certain grandfathering provisions found in Section 409(b)(3) and (c) of this Act. Many of our members have expressed confusion with the interpretation of these grandfathering provisions as it relates to qualification for a family office exemption. We suggest that additional guidance be provided by the Commission to ensure that the scope and intent of these provisions are accurately applied to existing family office arrangements.

Previously Issued Exemptive Orders

The AICPA supports the Commission's proposal to not rescind the exemptive orders previously issued to certain family offices. In addition, we believe that these family offices should also be able to rely on the Proposed Rule for an exemption, particularly in situations where (subsequent to obtaining an exemptive order) changes to the current family office and/or family investment structure are contemplated.

Other Matters

We have identified two other matters not specifically addressed in the Proposed Rule that we suggest warrant consideration by the Commission.

Investment Advisory Services Provided Without Compensation

We are aware of certain arrangements where a family office is providing investment advice for no compensation (direct or otherwise) to a client that may not necessarily qualify as a family client as currently defined in the Proposed Rule. For example, the family office may serve as the general partner of and/or investment adviser to a partnership, co-investing with both family clients and minority non-family clients. Another example is a family office that may provide investment advice to a family sponsored deferred compensation plan that includes as participants both key employees and non-key employees of the family office. In these situations, although the family office is providing investment advice, there is no compensatory arrangement (direct or otherwise) between the family office and the other members or participants. In such a case, we propose that a rule similar to Rule 203(b)(3)-1(b)(4), which states that "you are not required to count as a client any person for whom you provide investment advisory services without compensation," be included in the Proposed Rule to except these arrangements from further consideration as a family client.

Relief Provisions

Once the Commission finalizes the Proposed Rule, it is reasonable to anticipate that certain family offices may inadvertently and unintentionally be in violation of the guidelines, and therefore fail to qualify for an exemption from registration. As such, we recommend that the Commission consider the inclusion of a relief provision with necessary corrective measures to rectify inadvertent and unintentional violations.

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We appreciate the opportunity to comment and welcome the opportunity to serve as a resource to the Commission on these issues. If you have any questions or if we can be of further assistance, please contact Eric L. Johnson, Chair, AICPA Family Office Task Force, at ericljohnson@deloitte.com or (312) 486-4442; or F. Gordon Spoor, Chair, AICPA Trust, Estate, and Gift Tax Technical Resource Panel, at fgs@spoorcpa.com or (727) 343-7166; or Eileen Sherr, AICPA Senior Technical Manager, at esherr@aicpa.org, or (202) 434-9256.

Sincerely,

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