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November 17, 2010

VIA E-MAIL

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

Re: File No. S7-25-10: Proposed Rule 202(a)(11)(G)-1

Dear Ms. Murphy:

We submit this letter on behalf of one of our clients (the "Company") in response to a request for comments by the Securities and Exchange Commission (the "Commission") on proposed Rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940, as amended (the "Advisers Act").[1] This rule would define the term "family office" for purposes of the new exclusion from the definition of "investment adviser" provided by Section 202(a)(11)(G) of the Advisers Act, as enacted in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). We appreciate the opportunity to comment on the proposed rule.

As an initial matter, we wish to express the Company's full support for the analysis and comments provided in the letter submitted by Martin E. Lybecker on behalf of Private Investors Coalition, Inc. That letter addresses many of the practical effects of the proposed rule and offers many thoughtful recommendations for improving the rule in light of the existing structures and operations of most family offices.

We submit this separate comment letter to address in more detail our concerns about two aspects of the proposed rule: (1) the "wholly owned and controlled" requirement in subparagraph (b)(2) of the proposed rule, and (2) the "grandfathering" provision of paragraph (c) of the proposed rule.

1. Subparagraph (b)(2) of Proposed Rule 202(a)(11)(G)-1 – the "Wholly Owned and Controlled" Requirement

Briefly, the Company provides investment advice mainly to various entities ("Entities") that are beneficially owned by members of a wealthy family (the "Family"). "Family

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1 *See* Advisers Act Release No. 3098 (Oct. 12, 2010), 75 FR 63753 (Oct. 18, 2010) ("Proposing Release").

member" for this purpose is consistent with the definition of this term included in proposed Rule 202(a)(11)(G)-1. In addition to Family members, certain key employees of the Company also invest in these Entities. The Family members own, directly or indirectly, a majority of the outstanding voting and economic interests in the Company. The fundamental objective of the Company is to seek to maintain and maximize the wealth of Family members and a few others who have entrusted it to manage their assets.

Under subparagraph (b)(2) of proposed Rule 202(a)(11)(G)-1, a family office would have to be wholly owned and controlled, either directly or indirectly, by family members in order to come within the definition of "family office." For the reasons stated below, we believe that the Commission should also permit non-family members, such as key employees, to have a minority ownership interest in a "family office" (and in special purpose entities organized by the family office to serve as general partners and managers of Entities) that qualifies for the exclusion in Rule 202(a)(11)(G)-1.

First, although the Commission is correct in noting that most family offices that have obtained an exemptive order do not operate for the purpose of generating a profit,[2] there are others that operate differently and would like the flexibility to offer various types of financial incentives to key employees. Some may seek to provide financial incentives to their key employees by offering compensation packages that include stock or other forms of ownership in the family office, or a carried interest in the profits of the family office, similar to the types of incentives offered by commercial investment advisers. Offering these types of standard compensation packages to key employees should not transform a family office into a "family-run office" for purposes of the exclusion from the definition of investment adviser provided by Section 202(a)(11)(G) of the Advisers Act. For these family offices, simply providing the opportunity to participate in investments or to receive advice from the family office, as contemplated by the definition of "family client" in the proposed rule, may not be enough to attract the type of highly skilled investment professionals they may be seeking. A family office of this type competes with commercial investment advisers for the services of these individuals. At the end of the day, both types of advisers seek to maximize returns for their advisory clients by, among other things, having the best available portfolio management professionals.

Second, allowing key employees to own a minority stake in a family office, or special purpose management entity organized by the family office that would in turn constitute a family office, should not compromise the Commission's principal purpose for imposing an ownership and control condition in proposed Rule 202(a)(11)(G)-1. As the Commission stated, such a condition "assures that the family is in a position to protect its own interests and thus is less likely to need the protection of the Federal securities laws." [3]

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[2] *See* Proposing Release, supra n. 1 at text accompanying n. 52. The Commission explained that these family offices that have obtained exemptive orders have represented that they charge fees designed to just cover their costs.

[3] Proposing Release, supra n. 1 at text accompanying nn. 51-52.

Having a majority ownership interest in a family office should provide the members of a family with a sufficient degree of control to protect their interests. The family members in such case are no less capable of controlling their destiny, with respect to the strategic direction and operations of the office, as if they wholly owned the enterprise. This notion of control is consistent with the definition of "control" in paragraph (d)(1) of proposed Rule 202(a)(11)(G)-1.[4] In addition, because (as we propose) minority interests would be owned by key employees who (because of their seniority) can be expected to have a high degree of financial sophistication and to qualify as "accredited investors," there should not be any incremental need to impose the requirements of the Advisers Act in order to protect these individuals.

In order to further minimize the possible influence of any one key employee over the control of a family office, we believe that the Commission could provide that no individual non-family member may own more than 10% of the outstanding voting securities of a family office. In computing this 10% limit, the family office and all special purpose entities that may be established to serve as a general partner or managing member of a pooled investment vehicle should be viewed as parts of a single economic unit to the extent these entities are not operationally independent of each other. Thus, an individual's 10% limit would be determined as a percentage of the equity of the combined entities. In determining whether the family office and special purpose entities are operationally independent of each other, the Commission may look to the types of factors it has considered in the past when similar questions have arisen, such as the "separateness" factors that are considered on questions of Advisers Act registration,[5] or the "operationally independent" factors that are considered for purposes of the custody requirements under Advisers Act Rule 206(4)-2.[6]

Third, requiring that a family office be wholly owned and controlled is not necessary to distinguish a "family office" from a "family-run office" which, the Commission has stated, is more like a commercial investment adviser and would not be covered by the exclusion in proposed Rule 202(a)(11)(G)-1. In the Proposing Release, the Commission described the "family-run office" as a company that, although owned and controlled by a single family, "provides advice to a broader group of clients and much more resembles the business model common among many small investment adviser firms that are registered with the Commission or state regulatory authorities." [7] Elsewhere in the Proposing Release, the Commission observed that most family offices that have obtained an exemptive order under the Advisers Act "have represented that they did not operate for

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4 "Control" is defined in proposed Rule 202(a)(11)(G)-1 as the "power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of being an officer of such company."

5 *See, e.g., Ropes & Gray*, SEC No-Action Letter (Sept. 26, 1995).

6 *See* paragraph (d)(5) of Rule 206(4)-2.

7 *See* Proposing Release, supra n. 1 at text accompanying n. 9.

the purpose of generating a profit [but] charged fees designed to just cover their costs," and that this feature further helped to distinguish family offices from "family-run offices."[8] The Commission concluded that having a condition requiring exclusive ownership and control of a family office thus alleviates any concern it might have about the profit structure of the family office because any profits generated by the family office from managing family clients' assets accrue only to family members.

In our view, having an organizational structure in which certain key employees own a minority interest in a family office that seeks to provide financial incentives (of the types discussed above) to these employees should not make the office a "family-run office" as described by the Commission. A family office of this type is no more in need of the protections of the Advisers Act as a family office that is owned exclusively by family members. In such case, the focus remains on maximizing returns on assets managed for "family clients." Under the structure we propose, there will be no "broader group of clients" that will be advised by the family office. In addition, because family members own a majority interest in the family office, they will seek to assure that this objective (*i.e.*, to seek to maximize returns for "family clients") will not be compromised. Any concern for invoking the Advisers Act protections should not arise in these circumstances when one considers that those key employees who hold minority ownership interests in the family office are among the same persons who are co-investing as "family clients."

We note that in enacting Section 202(a)(11)(G) and granting the Commission rulemaking authority to define the term "family office," Congress provided the Commission with the flexibility to accommodate an ownership and control structure of the type we recommend. In Section 409(b) of the Dodd-Frank Act, Congress provided that the Commission should, among other things, "recognize[ ] the range of organizational, management, and employment structures and arrangements employed by family offices" in adopting a rule to define "family office." In the Senate Committee Report, Congress similarly stated that any rule adopted by the Commission should take into account "the range of organizational and employment structures employed by family offices." [9]

We do not believe that Congress intended that the Commission adopt a rule that simply codified the terms and conditions of the limited number of existing exemptive orders. We believe that Congress intended that the Commission consider other organizational forms and structures used by family offices and determine whether they could reasonably satisfy the objectives of the proposed rule. In our view, the structure we propose does so.

We also note that one objective of this new exclusion is to ensure that the number of advisers subject to registration with the Commission not increase in light of the repeal of the 15-client exemption contained in Section 203(b)(3) of the Advisers Act. If the Commission were to define "family office" narrowly to exclude advisers such as the

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8 *See* Proposing Release, supra n. 1 at text accompanying n. 52.

9 *See* S.Rep. No. 111-176, at 75-76 (2010).

Company, because it is not wholly owned and controlled by family members, there would likely be an increase in advisers subject to registration and a significant number of applications for exemptive orders submitted to the Commission. This would certainly run counter to Congress' intent in enacting this new exclusion.

2. Paragraph (c) of Proposed Rule 202(a)(11)(G)-1 – the "Grandfathering" Clause

We also have concerns about the scope of the "grandfathering" provision in paragraph (c) of the proposed rule. In order to implement the provisions of Section 409(b)(3) of the Dodd-Frank Act, the Commission has grandfathered (a) natural persons who (i) at the time of their investment, were officers, directors or employees of the family office, (ii) had invested with the family office before January 1, 2010, and (iii) were accredited investors as defined in Regulation D under the Securities Act of 1933, as amended, and (b) certain registered investment advisers. Section 409(b)(3)(C) of the Dodd-Frank Act also requires the Commission to grandfather "any company owned exclusively and controlled by members of the family of the family office, or as the Commission may prescribe by rule."

In accordance with the authority granted to it in Section 409(b)(3)(C), we encourage the Commission to grandfather trusts in which the natural persons described in paragraph (c)(1) of proposed Rule 202(a)(11)(G)-1 are the sole beneficiaries. There are existing arrangements in which a family office provides investment advice to trusts that, for various reasons, have been established for the benefit of officers, directors or employees of a family office, all of whom were "accredited investors" as defined in Regulation D under the Securities Act of 1933, as amended, at the time of "their applicable investment." We believe that the intent of the grandfathering provisions of paragraph (c)(1) would not be undermined if the Commission were to extend these provisions to these trusts.

We also encourage the Commission to exercise its authority in Section 409(b)(3)(C) to grandfather, subject to certain conditions described below, a few clients who would not be "family clients" under the proposed rule. Many family offices manage long-term assets that are illiquid, that would have substantial adverse tax consequences involved with their liquidation, or are otherwise invested in a pooled or joint manner that does not facilitate short-term separation, transfer or liquidation for management by another investment adviser. The proposed grandfathering provision should be expanded to permit continued management by a family office of existing assets under management, provided (1) the beneficial owners of those assets constitute financially sophisticated entities or individuals such as "qualified clients" within the meaning of Rule 205-3 promulgated under the Advisers Act, (2) no additional assets from those non-family clients are accepted or managed by the family office after January 1, 2010, (3) the total pre-existing non-family client assets do not exceed 30% of the total assets under management by the family office and its controlled family-office affiliates, and (4) neither the family office nor its controlled affiliates were required under Section 203 to register as an investment adviser immediately before July 21, 2011. This expanded grandfathering provision would allow for a more orderly disposition of assets currently managed by companies that otherwise would

constitute a family office under the proposed rule, and that were previously properly relying on the exemption from registration available under Section 203(b)(3) of the Advisers Act.

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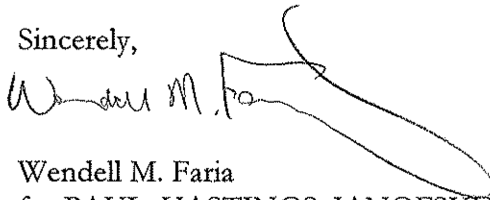
As we have indicated, an important objective of new Section 202(a)(11)(G) is to ensure that the number of "family offices" subject to registration with the Commission not increase in light of the repeal of the 15-client exemption contained in Section 203(b)(3) of the Advisers Act. The client on whose behalf we have prepared and submitted this letter has informed us that, if proposed Rule 202(a)(11)(G)-1 were to be adopted in its current form without substantially addressing the concerns expressed in this letter, it likely would direct us to prepare and submit an exemptive application concerning its status as an investment adviser. Because this would run counter to Congress' intent in enacting this new exclusion, we urge the Commission to consider the recommendations set forth herein.

We welcome the opportunity to discuss our proposals further with the staff of the Commission. If the Commission staff sees the need for such discussion, please contact David A. Hearth at (415) 856-7007 or Wendell M. Faria at (202) 551-1758. We very much thank the Commission for giving us this opportunity to comment and for giving due consideration to our recommendations.

Sincerely,



Wendell M. Faria
for PAUL, HASTINGS, JANOFSKY & WALKER LLP

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