I strongly encourage the public to closely analyze the language of each proposed rule and to provide the Commission with constructive and detailed comments on each of them. In particular, I am interested to know (i) what effect the Commission's proposed rules on voting and ownership limitations will have on competition, raising capital, and managing risk, and (ii) whether or not the open access and eligibility provisions in Sections 2(h)(1)(B) and 5b(c)(2)(c) of the Act would be a more effective method for the Commission to expand access to clearing, rather than placing limits on the voting and ownership of DCOs.

**Proposed Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest**

**Commissioner Jill E. Sommers, Dissenting**

The Commission is voting today on a proposal to implement two sections of the Dodd-Frank Act regarding the governance of CFTC regulated trading venues and clearinghouses that trade or clear swaps and how to mitigate conflicts of interest that may arise in connection with ownership interests that certain entities may have in these registrants. Specifically, Section 725(d) of the Act directs the Commission to:

Adopt rules mitigating conflicts of interest in connection with the conduct of business by a swap dealer or a major swap participant with at [DCO], [DCM], or a [SEF] that clears or trades swaps in which the swap dealer or major swap participant has a material debt or material equity investment.

Section 726 of the Act provides that the Commission shall adopt rules which "may" include numerical limits on the degree of control or voting rights that certain enumerated entities may possess with respect to DCOs, DCMs and SEFs if the Commission determines, after a review:

That such rules are necessary or appropriate to improve the governance of, or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with a swap dealer or major swap participant's conduct of business with, a [DCO], [DCM], or [SEF] that clears or posts swaps or makes swaps available for trading and in which such swap dealer or major swap participant has a material debt or equity investment.

I recognize that these provisions direct the Commission to adopt strong governance rules to mitigate conflicts of interest in connection with the interaction between swap dealers and major swap participants and DCOs, DCMs and SEFs in which they have a material debt or equity investment. In my opinion, however, the voting equity restrictions being proposed are not necessary or appropriate to mitigate the perceived conflicts and in fact, may do more harm than good to the emerging marketplace for trading and clearing swaps.

In 2009, after more than two years of study, the Commission finalized acceptable practices to provide a safe harbor for complying with Core Principle 15 for DCMs dealing with conflicts of interest. I support making those acceptable practices mandatory for DCMs, DCOs and SEFs, as augmented by some of the additional provisions being proposed today, such as the Risk Management Committee for DCOs. I believe that strong governance rules, coupled with the Commission's ultimate authority to determine which swaps must be cleared, under Section 723 of Dodd-Frank, is sufficient to ensure that swaps that should be listed for trading and cleared will be listed for trading and cleared.

I have grave concerns that the proposed limitations on voting equity, especially those proposed for enumerated entities in the aggregate with respect to DCOs, may stifle competition by preventing new DCMs, DCOs and SEFs that trade or clear swaps from being formed. The Commission recognizes in the preamble to the proposal that the enumerated entities will be the most likely source of funding for new DCMs and SEFs and thus chose not to propose the aggregate limits for trading venues. I believe the same logic applies with even greater force for DCOs. I am equally concerned that a number of recent entrants into the swaps trading and clearing space will potentially be required to disband their operations if they are unable to attract the required amount of non-voting equity within the two-year/two board election cycles proposed. I also note that the European Commission explicitly rejected ownership limitations in its proposal for regulating OTC derivatives announced September 15th because such limitations may have negative consequences for market structures. I agree. And I hope that we will be mindful of global consistency as we move forward. The marketplace for trading and clearing swaps is in its infancy. I strongly believe that the limitations the Commission is proposing will have the effect of inhibiting emerging competition rather than promoting it. I therefore cannot support today's proposal.

[FR Doc. 2010–26220 Filed 10–15–10; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Part 275

**[Release No. IA–3098; File No. S7–25–10]**

**RIN 3235–AK66**

## Family Offices

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** The Securities and Exchange Commission (the "Commission") is proposing a rule to define "family offices" that would be excluded from the definition of an investment adviser under the Investment Advisers Act of 1940 ("Advisers Act") and thus would not be subject to regulation under the Advisers Act.

**DATES:** Comments must be received on or before November 18, 2010.

**ADDRESSES:** Comments may be submitted by any of the following methods:

*Electronic Comments*

- Use the Commission's Internet comment form, *http://www.sec.gov/rules/proposed.shtml*; or
- Send an e-mail to *rule-comments@sec.gov.* Please include File Number S7–25–10 on the subject line; or
- Use the Federal eRulemaking Portal, *http://www.regulations.gov.* Follow the instructions for submitting comments.

*Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–25–10. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Web site, *http://www.sec.gov/rules/proposed.shtml.* Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549 on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Sarah ten Siethoff, Senior Special Counsel, or Vivien Liu, Senior Counsel, at (202) 551–6787 or *IArules@sec.gov,* Office of Investment Adviser Regulation, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–8549.

**SUPPLEMENTARY INFORMATION:** The Securities and Exchange Commission is requesting public comment on proposed rule 202(a)(11)(G)–1 [17 CFR 275.202(a)(11)(G)–1] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] (the "Advisers Act" or "Act").[1]

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[1] 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code, at which the Advisers Act is codified.

## I. Background

"Family offices" are entities established by wealthy families to manage their wealth, plan for their families' financial future, and provide other services to family members. Single family offices generally serve families with at least $100 million or more of investable assets.[2] Industry observers have estimated that there are 2,500 to 3,000 single family offices managing more than $1.2 trillion in assets.[3]

Family office services typically include managing securities portfolios, providing personalized financial, tax, and estate planning advice, providing accounting services, and directing charitable giving, in each case to members of a family. Some family offices even provide services such as travel planning or managing a family's art collection or household staff.[4] Family offices generally meet the definition of "investment adviser" under the Advisers Act, as we and our staff have interpreted the term, because, among the variety of services provided, family offices are in the business of providing advice about securities for compensation.[5]

We understand that many family offices have been structured to take advantage of the exemption from registration under section 203(b)(3) of the Advisers Act for any adviser that during the course of the preceding 12 months had fewer than 15 clients and neither held itself out to the public as an investment adviser nor advised any registered investment company or business development company.[6] Other family offices have sought and obtained from us orders under the Advisers Act declaring those offices not to be investment advisers within the intent of section 202(a)(11) of the Advisers Act.[7] We have issued more than a dozen of these orders since the 1940s.

The Commission issued those exemptive orders pursuant to a provision of the Advisers Act that authorizes us to exclude any person that falls within the Advisers Act's definition of investment adviser, but that we conclude is "not within the intent" of that definition.[8] We viewed the typical single family office as not the sort of arrangement that Congress designed the Advisers Act to regulate. We also were concerned that application of the Advisers Act would intrude on the privacy of family members. Thus, each of our orders exempted the particular family office from all of the provisions of the Advisers Act (and not merely the registration provisions). As a consequence, disputes among family members concerning the operation of the family office could be resolved within the family unit or, if necessary, through state courts under laws specifically designed to govern family disputes, but without the involvement of the Commission.

Our exemptive orders have included conditions designed to distinguish between a "family office," as described above, and a "family-run office" 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 smaller investment adviser firms that are registered with the Commission or state regulatory authorities.[9] Accordingly, and as described in more detail below, our exemptive orders have limited relief to those family offices that provide advisory services only to members of a single family and their lineal descendants, with very limited exceptions.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[10] The Dodd-Frank Act, among other matters, will repeal the 15-client exemption contained in section 203(b)(3) of the Advisers Act, effective July 21, 2011.[11] The primary purpose of repealing this exemption was to require advisers to private funds, such as hedge funds, to register under the Advisers Act.[12] But another potential consequence, which Congress recognized, was that many family offices that have relied on that exemption would be required to register under the Advisers Act or seek an exemptive order before that section of the Dodd-Frank Act becomes effective.

To prevent that consequence, section 409 of the Dodd-Frank Act creates a new exclusion from the Advisers Act in section 202(a)(11)(G), under which family offices, as defined by the Commission, are not investment advisers subject to the Advisers Act.[13] Section 409 instructs that any definition the Commission adopts should be "consistent with the previous exemptive policy" of the Commission and recognize "the range of organizational, management, and employment structures and arrangements employed by family offices." [14] We have taken this legislative instruction into account in

[2] *See* John J. Bowen, Jr., *In the Family Way,* Financial Planning (Aug. 1, 2004); Robert Frank, *Minding the Money—'Family Office' Chiefs Get Plied with Perks; Club Membership, Jets,* The Wall Street Journal (Sept. 7, 2007), at W2. A recent study found the average net worth of a single family office was $517 million. *See* Russ Alan Prince *et al.,* The Family Office: Advising the Financial Elite (2010) ("The Family Office").

[3] *See* Pamela J. Black, *The Rise of the Multi-Family Office,* Financial Planning (Apr. 27, 2010). A single family office generally provides services only to members of a single family.

[4] *See* Raphael Amit, *et al., Single Family Offices: Private Wealth Management in the Family Context,* Wharton Global Family Alliance (Apr. 1, 2008), *available at http://knowledge.wharton.upenn.edu/papers/1354.pdf* ("Wharton Study"); The Family Office, *supra* note 2; Angelo J. Robles, *Creating a Single Family Office for Wealth Creation and Family Legacy Sustainability,* Family Office Association, *available at http://familyofficeassociation.org/dwnld/FOA_White_Paper.pdf.*

[5] 15 U.S.C. 80b–2(a)(11). *See Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services,* Investment Advisers Act Release No. 1092 (Oct. 8, 1987) [52 FR 38400 (Oct. 16, 1987)]. There are certain exceptions to this definition, but the typical single family office does not meet any of these exceptions.

[6] 15 U.S.C. 80b–2(b)(3).

[7] *See, e.g., In the Matter of Donner Estates, Inc.,* Investment Advisers Act Release No. 21 (Nov. 3, 1941); *In the Matter of the Pitcairn Company,* Investment Advisers Act Release No. 52 (Mar. 2, 1949) ("Pitcairn"); *In the Matter of Roosevelt & Son,* Investment Advisers Act Release No. 54 (Aug. 31, 1949); *Bear Creek Inc.,* Investment Advisers Act Release Nos. 1931 (Mar. 9, 2001) (notice) [66 FR 15150 (Mar. 15, 2001)] and 1935 (Apr. 4, 2001) (order); *Riverton Management, Inc.,* Investment Advisers Act Release Nos. 2459 (Dec. 9, 2005) [70 FR 74381 (Dec. 15, 2005)] and 2471 (Jan. 6, 2006) (order).

[8] 15 U.S.C. 80b–2(a)(11)(G), which will be re-designated as 15 U.S.C. 80b–2(a)(11)(H) on July 21, 2010. If a person is excluded from the definition of an investment adviser, no state can require that person to register as an investment adviser. *See* 15 U.S.C. 80b–3A(b)(1).

[9] There also are commercial family offices, which are for-profit organizations that serve a much larger number of families and typically are registered as an investment adviser with the Commission or one or more states. *See* The Family Office, *supra* note 2. For example, GenSpring Family Offices, LLC reports on Part 1 of its Form ADV that it provides investment advisory services to 5000 clients.

[10] Pub. L. 111–203, 124 Stat. 1376 (2010).

[11] *See* section 403 of the Dodd-Frank Act.

[12] *See* S. Conf. Rep. No. 111–176, at 38–39 (2010) ("Senate Committee Report").

[13] The Senate Report 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." Senate Committee Report, *supra* note 12, at 75.

[14] Section 409(b) of the Dodd-Frank Act. Section 409 also includes a "grandfathering clause" that precludes us from excluding certain family offices from the definition solely because they provide investment advice to certain clients and had provided investment advice to those clients before January 1, 2010. *See* section 409(b)(3) of the Dodd-Frank Act.

formulating our proposed rule, as further detailed below.

**II. Discussion**

We propose to adopt new rule 202(a)(11)(G)–1 under the Advisers Act to define family offices that would be excluded from the definition of "investment adviser" under the Advisers Act. As a consequence, these family offices would not be subject to any of the provisions of the Advisers Act.

Proposed rule 202(a)(11)(G)–1 largely would codify the exemptive orders that we have issued to family offices. Each of these exemptive orders reflected the specific factual situation presented by the family office applicant. Drafting a rule defining family offices, however, requires us to turn these fact-specific exemptive orders into a rule of general applicability. Thus, the proposed rule would not (and could not) match the exact representations, conditions or terms contained in every exemptive order as they varied to accommodate the particular circumstances of each family office. For example, some of these orders have permitted specific individuals to be treated as a member of a family for purposes of the exemption.[15] Moreover, the Commission's views have changed over time as we have gained experience with family offices, and as we have been presented with new issues. Finally, some questions raised by this rulemaking have never been presented to us in the context of an exemptive request, but seem appropriate to address in a rule of general applicability.

The proposal, which we discuss in more detail below, reflects the Commission's current exemptive policy regarding family offices, and thus the policy judgments that we have made in granting the more recent orders, which Congress understood. Where terms and conditions in exemptive applications have varied over the years, we have sought to distill the policy rationale for the term or condition, and designed our proposed rule to align with the general policy.

The core policy judgment that formed the basis of our exemptive orders (and which prompted Congressional action) is the lack of need for application of the Advisers Act to the typical single family office.[16] The Act was not designed to regulate the interactions of family members in the management of their own wealth. Accordingly, most of the conditions of the proposed rule (like our exemptive orders) operate to restrict the structure and operation of a family office relying on the rule to activities unlikely to involve commercial advisory activities, while permitting traditional family office activities involving charities, tax planning, and pooled investing.

Finally, we note that the failure of a family office to be able to meet the conditions of this rule would not preclude the office from providing advisory services to family members either collectively or individually. In such a situation, a family office could seek an exemptive order from the Commission or, in the absence of such an order, the family office would be subject to the Advisers Act and would have to register unless another exemption is available. A number of family offices currently are registered under the Advisers Act.

We request comment generally on our approach to the proposed rule and its implementation of section 409 of the Dodd-Frank Act. Are other approaches available that we should consider?

*A. Family Office Structure and Scope of Activities*

As discussed below, the proposed rule contains three general conditions. First, it would limit the availability of the rule to family offices that provide advice about securities only to certain family members and key employees. Second, it would require that family members wholly own and control the family office. Third, it would preclude a family office from holding itself out to the public as an investment adviser. In addition to these conditions, we have incorporated into the rule the "grandfathering" provision required by section 409 of the Dodd-Frank Act.[17]

1. Family Clients

We propose that excluded family offices not be permitted to have any investment advisory clients other than "family clients."[18] As discussed in more detail below, family clients would include family members, certain employees of the family office, charities established and funded exclusively by family members or former family members, trusts or estates existing for the sole benefit of family clients, and entities wholly owned and controlled exclusively by, and operated for the sole benefit of, family clients (with certain exceptions), and, under certain circumstances, former family members and former employees.

a. Family Member

We propose to define the term "family member" to include the individual and his or her spouse or spousal equivalent for whose benefit the family office was established and any of their subsequent spouses or spousal equivalents, their parents, their lineal descendants (including by adoption and stepchildren), and such lineal descendants' spouses or spousal equivalents.[19] Except as discussed below, this definition generally corresponds to the types of clients that family offices have advised under our exemptive orders.

Our exemptive orders issued to family offices typically have included adopted children as family members because adopted children generally are not treated differently as a legal matter than children by birth.[20] However, our exemptive orders have not always included stepchildren as "family members."[21] Proposed rule 202(a)(11)(G)–1 would include stepchildren as family members. We recognize that stepchildren are not treated as consistently as adopted children under relevant tax, family, and

[15] *See, e.g., Adler Management, L.L.C.,* Investment Advisers Act Release Nos. 2500 (Mar. 21, 2006) [71 FR 15498 (Mar. 28, 2006)] (notice) and 2508 (Apr. 14, 2006) (order) ("Adler") (permitting one particular "long-standing loyal family employee" to hold a beneficial interest in a family entity advised by the family office).

[16] We note that the proposed rule would exclude directors, partners, trustees, and employees of family offices from regulation under the Advisers Act only when they are acting within the scope of their position or employment.

[17] *See supra* note 14 and section II.A.4 of this release.

[18] Proposed rule 202(a)(11)(G)–1(b)(1).

[19] Proposed rule 202(a)(11)(G)–1(d)(3).

[20] *See, e.g., WLD Enterprises, Inc.,* Investment Advisers Act Release Nos. 2804 (Oct. 17, 2008) [73 FR 63218 (Oct. 23, 2008)] (notice) and 2807 (Nov. 14, 2008) (order) ("WLD"); *Woodcock Financial Management Company,* LLC, Investment Advisers Act Release Nos. 2772 (Aug. 26, 2008) [73 FR 51322 (Sept. 2, 2008)] (notice) and 2787 (Sept. 24, 2008) (order); Adler, *supra* note 15. For an example of the legal treatment of adopted children, *see, e.g.,* National Conference of Commissioner on Uniform State Laws, *Uniform Adoption Act,* (1994), at § 1–104 (each adoptive parent and the adoptee have the legal relationship of parent and child and have all the rights and duties of that relationship). This treatment is also reflected in Federal laws. For example, section 2(a)(51)(ii) of the Investment Company Act of 1940 recognizes adopted children as "lineal descendants" for purposes of determining whether a person is a "qualified purchaser."

[21] Our exemptive orders issued to family offices in two instances have included family offices advising stepchildren. *See* WLD, *supra* note 20 (included two stepchildren of the patriarch's son and their spouses and children, but required that those individuals be provided with written disclosure describing the material terms and effects of the exemptive order and that the office obtain written consent from these individuals); *Woodcock Financial Management Company, LLC,* Investment Advisers Act Release Nos. 2772 (Aug. 26, 2008) [73 FR 51322 (Sept. 2, 2008)] (notice) and 2787 (Sept. 24, 2008) (order) ("Woodcock") (including matriarch's children from a former marriage and their lineal descendants, and the spouses of such children and descendents).

estate law.[22] However, we are proposing including stepchildren in our definition of a family client based on our understanding of their close ties to the family members who would be included in the definition, and on the fact that permitting stepchildren to be included as clients of the family office leaves to the family members whether they wish to include stepchildren as part of the family office clientele. Indeed, nothing in our proposed rule would mandate that the family office provide advice to any particular family member; it simply permits such advice.[23] We request comment on our proposed inclusion of stepchildren within the meaning of the term "family members" for purposes of the "family office" definition. Should we include stepchildren? Are there any additional conditions that we should impose if stepchildren are included?

We also propose including "spousal equivalents," using the definition of that term currently used under our auditor independence rules.[24] We are not aware of any applicant that requested that spousal equivalents be included as a permitted client of any family office covered by our exemptive orders, and thus have never provided such relief. However, we believe that permitting spousal equivalents to be a family office client seems appropriate in a rule of general applicability. We request comment on our proposed definition of spousal equivalent.

The proposed rule also would permit a family office relying on the exclusion to provide investment advice to parents of the family office's founders.[25] While the family offices that have obtained an exemptive order from the Commission typically were managing wealth built by an older generation—and thus the "parents" are typically the "founders," we understand that this may not always be the case. For example, some entrepreneurs (such as in the technology and private fund management sectors) have built sizeable fortunes at an early age and may form a family office.[26] These younger founders may wish to include one or more of their parents as a client of the family office. We request comment on including parents of the founders as a "family member" under the proposed rule.

Our proposed definition of "family member" also would include siblings of the founders of the family office, their spouses or spousal equivalents, their lineal descendants (including by adoption and stepchildren), and such lineal descendants' spouses or spousal equivalents.[27] We have issued an exemptive order to a family office that advised siblings of one of the founders and certain of those siblings' descendants.[28] These individuals have close family ties to the founders and allowing family members to choose to include these individuals as family office clients does not appear to us to expand the family office's clientele to such an extent that it starts to resemble a typical commercial investment adviser. We request comment on including siblings and their spouses and descendants in the definition of family client.

More generally, we request comment on our definition of family member. Are we drawing the line too broadly or too narrowly regarding when the clientele of a family office starts to resemble that of a typical commercial investment adviser and not a single family? For example, certain legally created relationships such as certain types of guardianships may resemble the type of relationship that is included in the definition of family member depending on the facts and circumstances. Are there other types of family members that should be included? Why or why not? We note that family offices would still be able to seek a Commission exemptive order if they wanted to continue to advise family that did not meet our proposed definition of family member.

We are aware that some families have added other families to their family office's clientele to achieve economies of scale and thus save on costs.[29] The rule would not extend to family offices serving multiple families. We have never granted an exemptive order to a multifamily office declaring them not to be an investment adviser and thus including them would seem to be inconsistent with our prior exemptive policy. Many multifamily offices more resemble a typical commercial investment adviser appropriately subject to the Advisers Act. Should we permit multifamily offices to operate under this exclusion from the Advisers Act? If so, how would we distinguish between a multi-family commercial office and an office more closely resembling those operating under our exemptive orders (except providing advice to multiple families)?

b. Involuntary Transfers

We recognize that family offices may encounter situations in which assets under management are transferred involuntarily. We note that one implication of the proposed rule would be that a family office could continue to provide advice without becoming an investment adviser under the Advisers Act to a person that receives assets in an involuntary transfer only if the involuntary transaction is to a person that is a family client. For example, if

[22] For example, under state inheritance law, stepchildren typically are not granted the inheritance rights of genetic children unless they are adopted. *See, e.g.,* Mass. Gen. Laws Ann. Ch. 190B, § 1–201(5) (West 2010); Alaska Stat. § 13.06.050(5) (2010); Fla. Stat. Ann. § 731.201(3) (West 2010); Haw. Rev. Stat. § 560:1–201(5) (2009), (32). *See also* Susan N. Gary, *We Are Family: The Definition of Parent and Child for Succession Purposes,* 34 ACTEC J. 171, 172 (Winter 2008). Other states provide limited inheritance rights to stepchildren. *See, e.g.,* Cal. Prob. Code § 6454 (West 2010) (stating that a stepchild may inherit through intestate succession if (1) the relationship began during the child's minority and continued throughout the joint lifetimes of the child and the child's stepparent and (2) it is established by clear and convincing evidence that the stepparent would have adopted the stepchild but for a legal barrier); Conn. Gen. Stat. Ann. § 45a–439(a)(1) (West 2010) (stating that if a person dies intestate without any surviving children, spouse, parents, siblings, or other next of kin, then the estate is distributed to stepchildren rather than escheat to the state); Md. Code Ann., Est. & Trusts § 3–104(e) (2010) (same). Other legal contexts have been more generous in ascribing legal rights to stepchildren. For example, some states have inheritance tax statutes that treat stepchildren the same as natural or adopted children. *See* Wendy C. Gerzog, *Families for Tax Purposes: What About the Steps?,* 42 U. Mich. J.L. Reform 805, at n.37 and accompanying text (Summer 2009). The laws of inheritance are beginning to ascribe more rights to stepchildren. In 2008, the Uniform Probate Code was amended to recognize as a "child" for purposes of intestate succession any child for whom a parent-child relationship exists, regardless of whether the child's genetic parents are married and regardless of whether the child is a genetic child of each parent. *See* Uniform Probate Code §§ 2–115 to 2–122. Some states have begun to amend their intestacy laws to reflect these amendments. *See, e.g.,* H.B. 09–1287, 67th Gen. Assem., 1st Reg. Sess. (Colo. 2009); H.B. 1072, 61st Leg. Assem., Reg. Sess. (N.D. 2009).

[23] Thus, for example, this context differs from the intestacy context where family is often defined narrowly because the decedent is not alive to state whether or not he or she wishes his or her stepchildren to inherit his or her estate.

[24] *See* 17 CFR 210.2–01(f)(9) and (13); *Revision of the Commission's Auditor Independence Requirements,* Securities Act Release No. 7919 (Nov. 21, 2000) [65 FR 76008 (Dec. 5, 2000)], at section IV.H.8. Spousal equivalent is defined as a cohabitant occupying a relationship generally equivalent to that of a spouse. *See* proposed rule 202(a)(11)(G)–1(d)(7).

[25] Proposed rule 202(a)(11)(G)–1(d)(3).

[26] *See, e.g., Google Executives Eye Family Office,* Private Asset Management (Dec. 5, 2005), at 1; Jim Grote, Old Money vs. New Money, Financial Advisor Magazine (May 2003).

[27] Proposed rule 202(a)(11)(G)–1(d)(3).

[28] The order was to a family office that advised siblings of one of the founders, those siblings' spouses, their children and their spouses, and their grandchildren and spouses (the applicant was required to give these individuals a disclosure statement describing the material legal effects associated with a Commission order exempting the family office from regulation under the Advisers Act). *See* WLD, *supra* note 20.

[29] *See* Hannah Shaw Grove & Russ Alan Prince, *E Pluribus Unum,* Registered Rep (May 1, 2004). These multi-family offices generally serve families with a lesser average net worth. *See* The Family Office, *supra* note 2 (finding that the average net worth for a multi-family office client to be $116 million).

a family member in his will left assets in a family office-advised private fund to a charity that did not qualify as a family client, generally after that family member died the family office could not continue to provide investment advice with respect to those assets and still rely on rule 202(a)(11)(G)–1 to be excluded from the definition of an investment adviser. The proposed rule would permit the family office to continue to advise such a client without violating the terms of the exclusion for four months following the transfer of assets resulting from the involuntary event, which should allow that family office to orderly transition that client's assets to another investment adviser, seek exemptive relief, or otherwise restructure its activities to comply with the Advisers Act.[30]

We believe that this treatment of involuntary transfers is appropriate because after such a bequest, the office would no longer be providing advice solely to members of a single family, and after several such bequests the office would cease to operate as a family office. Indeed, we have never issued an exemptive order to a family office permitting involuntary transfers to non-family members. However, we recognize that the Commission in some contexts has treated involuntary transfers in this manner and in other contexts permitted involuntary transfers outside the family.[31] We request comment on our proposed approach regarding involuntary transfers. Should we permit family clients to transfer assets advised by the family office to non-family clients if there is a death or other involuntary event without jeopardizing the ability of the family office to rely on the exclusion under proposed rule 202(a)(11)(G)–1? If so, under what conditions and to what types of transferees? How would we distinguish between a typical commercial adviser serving both related and unrelated clients from a family office resembling those operating under our prior exemptive orders? Should we allow a different period of time or transition mechanism to transfer assets that a non-family client receives in an involuntary transfer to another investment adviser?

c. Former Family Members

None of our exemptive orders have permitted former family members to receive investment advice from an exempt family office.[32] However, we recognize that divorces and other events may occur in some families covered by the rule and that addressing in our proposed rule the effect of these circumstances on the family office would provide clarity to family offices affected by such a legal separation from the family.

We propose permitting former family members, *i.e.,* former spouses, spousal equivalents and stepchildren, to retain any investments held through the family office at the time they became a former family member.[33] However, we propose to limit former family members from making any new investments through the family office.[34] Our approach is designed to prevent such a separation from resulting in harmful investment or tax consequences, while also recognizing that such persons are no longer members of the family controlling the office, and thus would not be subject to the protections we assume accompany membership in a family. We request comment on this approach. Should we exclude former family members? Are there other approaches to treating such persons that we should consider?

d. Family Trusts, Charitable Organizations, and Other Family Entities

We also propose to treat as a "family client" any charitable foundation, charitable organization, or charitable trust established and funded exclusively by one or more family members[35] and any trust or estate existing for the sole benefit of one or more family clients.[36] Similarly, we would also treat as a family client any company,[37] 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.[38] We generally have included these types of companies and organizations when owned and controlled by family members to be treated as permitted clients of the family office under our exemptive orders.[39] Including them should allow the family office to structure its activities through typical investment structures. We request comment on this aspect of our proposal.

[30] Proposed rule 202(a)(11)(G)–1(b)(1).

[31] For example, under our rules addressing the exclusion of private funds from the definition of an investment company, the Commission has treated an involuntary transfer of securities as if the transfer had not occurred, consistent with the direction from Congress in the Investment Company Act. *See* 15 U.S.C. 80a–3(c)(1)(B) 15 U.S.C. 80a–3(c)(7)(A); 17 CFR 270.3c–6. However, under our rules relating to the registration of securities pursuant to certain compensatory benefit plans, we have only permitted involuntary transfers to family members without jeopardizing the ability of the person to continue to rely on the exemptive provision. *See* 17 CFR 230.701 (exempting offers and sales of securities under a written compensatory benefit plan or written compensation contract for the participation of employees, directors, general partners, trustees, officers, or consultants and advisors, and their family members who acquire such securities from such persons through gifts or domestic relations orders). *See also* General Instruction A.1(a)(5) to Form S–8 (The form also is available for the exercise of employee benefit plan options and the subsequent resale of the underlying securities by an employee's family member who has acquired the options from the employee through a gift or a domestic relations order.); *Registration of Securities on Form S–8,* Securities Act Release No. 7646 (Feb. 26, 1999) [64 FR 11103 (Mar. 8, 1999)], at section III.A.2 (explicitly rejecting expanding the availability of the abbreviated disclosure in Form S–8 for the exercise of employee benefit plan options transferred by gift to charities or to other "unrelated persons who are the object of the employee's generosity" and stating that "[w]hile we seek to facilitate employees' estate planning through the amendments we adopt today, we must keep in mind that investor protection is our primary objective" and to "permit entities that are not controlled by, or for the primary benefit of, an employee's family members to exercise options on Form S–8 would suggest that the abbreviated Form S–8 disclosure is adequate for the offer and sale of securities to non-employees generally. As discussed above, we remain firmly persuaded of the contrary view.").

[32] By including in the definition of "founders" any subsequent spouse of a founder, our proposed rule would address the situation in which the founders divorce and one or both of the founders subsequently remarries. *See* proposed rule 202(a)(11)(G)–1(d)(5). Again, we are not aware of any applicant for an exemptive order having requested that the order cover this situation, but in formulating a rule of general applicability, we thought it important to address the impact of this situation on the family office's exclusion under the Advisers Act.

[33] Proposed rule 202(a)(11)(G)–1(d)(2)(vi), and (d)(4).

[34] The proposed rule would permit the family office to provide investment advice with respect to additional investments that the former spouse or spousal equivalent was contractually obligated to make, and that relate to a family-office advised investment existing, prior to the time the person became a former spouse or spousal equivalent (*e.g.,* if the individual has a previously existing capital commitment to a private fund advised by the family office). *See* proposed rule 202(a)(11)(G)–1(d)(2)(vi).

[35] Proposed rule 202(a)(11)(G)–1(d)(2)(iii).

[36] Proposed rule 202(a)(11)(G)–1(d)(2)(iv).

[37] "Company" is defined in section 202(a)(5) of the Advisers Act to mean "a corporation, a partnership, an association, a joint-stock company, a trust, or any organized group of persons, whether incorporated or not; or any receiver, trustee in a case under title 11, or similar official, or any liquidating agent for any of the foregoing, in his capacity as such."

[38] Proposed rule 202(a)(11)(G)–1(d)(2)(v). Under proposed rule 202(a)(11)(G)–1(d)(1), control would be defined as the power to exercise a controlling influence over the management or policies of an entity, unless such power is solely the result of being an officer of such entity. If any of these companies are pooled investment vehicles, they must be exempt from registration as an investment company under the Investment Company Act of 1940 because the Advisers Act requires that an adviser to a registered investment company must register. *See* 15 U.S.C. 80b–3a(a)(1)(B).

[39] *See, e.g.,* Woodcock, *supra* note 21; *Kamilche Company,* Investment Advisers Act Release Nos. 1958 (Jul. 31, 2001) [66 FR 41063 (Aug. 6, 2001)] (notice) and 1970 (Aug. 27, 2001) (order).

e. Key Employees

We also are proposing to treat as family members certain key employees of the family office so that they may receive investment advice from and participate in investment opportunities provided by the family office. Such persons have been treated like family members in some of our exemptive orders.[40] Permitting participation by key employees allows such family offices to incentivize key employees to take a job with the family office and to create positive investment results at the family office under terms that could be available to them as employees of other types of money management firms. It is our understanding that in some cases family offices may need to provide such incentives to attract highly skilled investment professionals who may not otherwise be attracted to work at a family office.[41]

The Dodd-Frank Act acknowledges the Commission's exemptive policy in this area by requiring that in defining a "family office" we "recognize the range of organizational, management, and employment structures and arrangements employed by family offices" in defining excluded family offices.[42] The Senate committee report explained that some family offices have non-family member directors, officers, and employees that may co-invest with family members, enabling them to share in the profits of investments that they oversee and better aligning the interests of such persons with those of the family members served by the family office.[43] The report states that it expected that "such arrangements would not automatically exclude a family office from the definition." [44]

The proposed rule would permit the family office to provide investment advice to any natural person (including persons who hold joint and community property with their spouse) 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 the investment activities of the family office, or similar functions or duties for or on behalf of another company, for at least twelve months.[45]

We believe that this standard would limit employees who participate without the protections of the Advisers Act (or family membership) to those employees that are likely to be in a position or have a level of knowledge and experience in financial matters sufficient to be able to evaluate the risks and take steps to protect themselves. This definition of key employee is based on the "knowledgeable employee standard" currently contained in Advisers Act rule 205–3(d)(iii), which specifies the types of clients to whom the adviser may charge performance fees.[46] We adopted the knowledgeable employee exception in the performance fee rule based on a similar policy conclusion that these types of employees are likely to be sophisticated financially and not need the protections of the Advisers Act's restrictions on performance fees.[47]

Similar to our treatment of family members under the proposed rule, key employees would be able to structure their investments through trusts and other entities, subject to the conditions relating to control and ownership described earlier in this Release.[48] Upon the end of key employees' employment by the family office, key employees (including their trusts and controlled entities) would not be permitted to make additional investments through the family office.[49] Similar to our treatment of former spouses, spousal equivalents, and stepchildren, our proposed rule would not require former key employees to liquidate or transfer investments held through the family office at the time of the end of their employment, however, to avoid imposing possible adverse tax or investment consequences that might otherwise result.

We request comment on our proposed treatment of investments by employees of the family office. Should we permit key employees to receive investment advice through the family office? Do family offices rely on allowing co-investment to attract talented investment professionals to work at the family office? Should the definition of key employee be based on the knowledgeable employee standard in rule 205–3 under the Advisers Act? Are there restrictions that we should consider imposing as a condition to such investment to help protect non-family members investing through the family office? Should we allow former key employees to retain their investments through the family office at the time of termination? Are any of our conditions too restrictive? For example, should we modify or eliminate the 12-month experience requirement for key employees? If so, how and why? Are there other types of individuals or entities that should be permitted to invest through the family office without jeopardizing that family office's exclusion under the Advisers Act?

More broadly, we request comment on our definition of who is considered a "family client." We have not included every type of individual or entity that has been included in a prior exemptive order based on specific facts and circumstances. We do not believe we could have taken such an approach in a rule of general applicability and we note that family offices would remain free to seek a Commission exemptive order to advise an individual or entity

[40] *See, e.g.,* WLD, *supra* note 20 (family office provided investment advice to several executives of the family business and their trusts); Gates Capital Partners, LLC/Bear Creek, Inc., Investment Advisers Act Release Nos. 2590 (Feb. 16, 2007) [72 FR 8405 (Feb. 26, 2007)] (notice) and 2599 (Mar. 20, 2007) (order) (two pooled investment vehicles advised by the family office had non-voting interests owned by certain senior employees of the family office); Adler, *supra* note 15 (one long-standing employee held interest in one family office advised entity). These key employees typically either had their investments frozen or were permitted to continue their side-by-side investments through the family office but upon termination of employment were limited to investments at the time of termination along with reinvestment of accretions or distributions on the investment.

[41] *See e.g.,* Robert Frank, *Minding the Money—'Family Office' Chiefs Get Plied with Perks; Club Membership, Jets.* The Wall Street Journal, at W2 (Sept. 7, 2007) ("a growing number of wealthy families are dangling the biggest perk of all: allowing their family office manager to become a "participant," investing his or her own funds along with the family money in big deals"). *But see* Thomas Coyle, *Family Offices Mostly unscathed by Overhaul,* Dow Jones News Service (Jul. 16, 2010) ("family office recruiters don't think co-investment plays a big role in attracting family office managers").

[42] Section 409(b)(2) of the Dodd-Frank Act.

[43] Senate Committee Report, *supra* note 12, at 76.

[44] *Id.*

[45] Proposed rule 202(a)(11)(G)–1(d)(6). The proposed rule also would permit the family office to provide investment advice to trusts created for the sole benefit of family clients (which could include these key employees), and to other entities wholly owned and controlled by and operated for the sole benefit of family clients. Proposed rule 202(a)(11)(G)–1(d)(2)(iv)–(v).

[46] The knowledgeable employee standard in Advisers Act rule 205–3 was itself based on the similar standard under the Investment Company Act of 1940 for knowledgeable employees of private funds that are exempt from registration under the Investment Company Act through section 3(c)(1) or 3(c)(7) of the Investment Company Act. *See* rule 3c–5 under the Investment Company Act [17 CFR 270.3c–5]; *Exemption To Allow Investment Advisers To Charge Fees Based upon a Share of Capital Gains upon or Capital Appreciation of a Client's Account,* Investment Advisers Act Release No. IA–1731 (Jul. 15, 1998) [63 FR 39022 (Jul. 21, 1998)], at nn.24–28 and accompanying text.

[47] *See Exemption To Allow Investment Advisers To Charge Fees Based upon a Share of Capital Gains upon or Capital Appreciation of a Client's Account,* Investment Advisers Act Release No. IA–1731 (Jul. 15, 1998) [63 FR 39022 (Jul. 21, 1998)], at nn.24–28 and accompanying text.

[48] *See* section II.A.1.d of this Release. *See also* WLD, *supra* note 20 (permitting the family office to advise key employee trusts).

[49] Proposed rule 202(a)(11)(G)–1(d)(2)(vii).

that does not meet our proposed family client definition. However, we request comment on our approach. Are there other individuals or entities that should be included? Under our proposed rule, the family office could not provide investment advice to a person that may have a long employment relationship with the family but does not qualify as a "key employee." Are there other types of individuals that commonly have close ties to a family that should be included as a family client? We note that as a family office extends its provision of investment advice beyond family members, it increasingly resembles a more typical commercial investment advisory business, and not a family managing its own wealth.

2. Ownership and Control

We propose that to operate under the proposed exclusion from the Advisers Act the family office be wholly owned and controlled, either directly or indirectly, by family members.[50] This condition generally is consistent with our exemptive orders [51] and 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.

This condition also helps distinguish family offices from family-run offices that may provide advice to other people, as well as other families, and operates as a more typical commercial investment adviser. Most family offices that have obtained an exemptive order from the Commission under the Advisers Act have represented that they did not operate for the purpose of generating a profit and charged fees designed to just cover their costs.[52] This feature helped distinguish these family offices from the family-run investment advisory businesses that the Advisers Act appropriately regulates. Requiring that the family office be wholly owned by family members alleviates any concern that we may otherwise have about the profit structure of the family office, because any profits generated by the family office from managing family clients' assets only accrue to family members. Accordingly, we are not proposing a specific condition regarding whether the family office generates a profit.

We request comment on the condition that the family office be wholly owned and controlled by family members. Are there reasons that we should not require that the family office be wholly owned and controlled by family members? Should some minor ownership stake of non-family members be permitted? [53] If we permitted non-family members to own a minor ownership stake in the family office, what other protections should we impose to ensure that the family office did not operate as a more typical commercial investment adviser? Are there other restrictions on ownership and control of the family office that we should impose consistent with our policy goals? Should we also require that the family office be operated without the intent of generating a profit or only charge fees designed to cover its costs and the compensation of its employees?

3. Holding Out

Consistent with our exemptive orders,[54] we propose to prohibit a family office relying on the rule from holding itself out to the public as an investment adviser.[55] Holding itself out to the public as an investment adviser suggests that the family office is seeking to enter into typical advisory relationships with non-family clients, and thus is inconsistent with the basis on which we have provided exemptive orders and this proposed rule.[56] We request comment on this proposed condition. Are there circumstances where a family office holding itself out to the general public as an investment adviser should nevertheless be excluded from the protections afforded to the investing public under the Advisers Act?

4. Grandfathering Provisions

The Dodd-Frank Act prohibits us from excluding from our definition of family office persons not registered or required to be registered on January 1, 2010 that would meet all of the required conditions under rule 202(a)(11)(G)–1 but for their provision of investment advice to certain clients specified in section 409(b)(3) of the Dodd-Frank Act.[57] We have incorporated this required grandfathering into paragraph (c) of our proposed rule.[58]

*B. Effect of Rule on Previously Issued Exemptive Orders*

As discussed above, the Commission has issued orders under section 202(a)(11)(G) of the Advisers Act to certain family offices declaring them and their employees acting within the scope of their employment to not be investment advisers within the intent of the Act. In some areas these exemptive orders may be slightly broader than the rule we are proposing today, and in other areas they may be narrower.

We are not proposing to rescind the orders we have issued to family offices because we do not believe that the policy behind the previously issued orders differs substantially from that of our proposal. Further, single family offices do not compete with one another and thus there is no need to rescind exemptive orders to create a "level playing field." Family offices currently

[50] Proposed rule 202(a)(11)(G)–1(b)(2).

[51] *See, e.g.,* WLD, *supra* note 20 (requiring that a majority of the board of directors of the family office be comprised of family members and that the family office be wholly owned by family members); *Slick Enterprises, Inc.,* Investment Advisers Act Release Nos. 2736 (May 22, 2008) [73 FR 30984 (May 29, 2008)] (notice) and 2745 (June 20, 2008) (order) (same) ("Slick").

[52] *See, e.g.,* WLD, *supra* note 20; Adler, *supra* note 15; *Parkland Management Company, L.L.C.,* Investment Advisers Act Release Nos. 2362 (Feb. 24, 2005) [70 FR 10155 (Mar. 2, 2005)] (notice) and 2369 (Mar. 22, 2005) (order); *Longview Management Group LLC,* Investment Advisers Act Release Nos. 2008 (Jan. 3, 2002) [67 FR 1251 (Jan. 9, 2002)] (notice) and 2013 (Feb. 7, 2002) (order).

[53] In one case we granted an exemptive order to a family office in which four churches owned a small interest in the family office. *See* Pitcairn, *supra* note 7. In one other case we granted an exemptive order to a family office owned by a trust in which half of the trustees were independent and half of the trustees were family members. *See Moreland Management Company,* Investment Advisers Act Release Nos. 1700 (Feb. 12, 1998) [63 FR 8710 (Feb. 20, 1998)] (notice) and 1706 (Mar. 10, 1998) (order).

[54] *See, e.g.,* WLD, *supra* note 20; Woodcock, *supra* note 21; Slick, *supra* note 51.

[55] Proposed rule 202(a)(11)(G)–1(b)(3).

[56] We note that the exemption from registration under section 202(b)(3) of the Advisers Act is not available to a person that holds himself out as an investment adviser. In addition, our staff has stated that a person that holds himself out as an investment adviser or as one who provides investment advice satisfies the "in the business" element of being an investment adviser under the Advisers Act. *See Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services,* Investment Advisers Act Release No. 1092 (Oct. 8, 1987) [52 FR 38400 (Oct. 16, 1987)].

[57] *See* section 409(b)(3) and (c) of the Dodd-Frank Act. The family office must have been providing investment advice to such clients before January 1, 2010. The grandfathered clients are natural persons who, at the time of their investment, are officers, directors, or employees of the family office, and had invested with the family office before January 1, 2010. These clients must be accredited investors under Regulation D of the Securities Act of 1933. The other grandfathered clients are investment advisers registered under the Advisers Act that in turn provide investment advice and identify investment opportunities to the family office and invest in such transactions on substantially the same terms as the family office invests, but does not invest in other funds advised by the family office and whose assets as to which the family office directly or indirectly provides investment advice represent, in the aggregate, not more than 5% of the value of the total assets as to which the family office provides investment advice. *See* proposed rule 202(a)(11)(G)–1(c).

[58] A family office that will only qualify for the exclusion under section 202(a)(11)(G) of the Advisers Act, as amended by the Dodd-Frank Act, because of section 409(b)(3) of the Dodd-Frank Act will still be subject to paragraphs (1), (2) and (4) of section 206 of the Advisers Act. *See* section 409(c) of the Dodd-Frank Act.

operating under these orders could continue to rely on those orders or, if they meet the conditions of proposed rule 202(a)(11)(G)–1, they could rely on the rule. We request comment on whether we should rescind previous orders granted to family offices under section 202(a)(11)(G) of the Advisers Act. Should we rescind the very early orders that did not impose all of the same conditions as more recent orders?

## III. General Request for Comment

The Commission requests comment on the rule proposed in this Release, suggestions for additional changes to the existing rules and comment on other matters that might have an effect on the proposals contained in this Release. Commenters should provide empirical data to support their views.

## IV. Paperwork Reduction Act

Proposed rule 202(a)(11)(G)–1 does not contain a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995.[59] Accordingly, the Paperwork Reduction Act is not applicable.

## V. Cost-Benefit Analysis

We have identified certain costs and benefits of the proposed new rule, and we request comment on all aspects of this cost benefit analysis, including identification and assessment of any costs and benefits not discussed in this analysis. We seek comment and data on the value of the benefits identified. We also welcome comments on the accuracy of the cost estimates in this analysis, and request that commenters provide data that may be relevant to these cost estimates. In addition, we seek estimates and views regarding these costs and benefits for particular family offices as well as any other costs or benefits that may result from the adoption of the proposed new rule.

In proposing this rule, we are responding to the Dodd-Frank Act's repeal of section 203(b)(3) of the Advisers Act and proposing a new exclusion for a "family office," which Congress anticipated we would define.[60] Proposed rule 202(a)(11)(G)–1 would exclude from regulation under the Advisers Act family offices that meet the qualifications and conditions contained in the proposed rule. Among other matters, to qualify as an excluded family office, the family office generally must have no non-family clients, must be wholly owned and controlled by family members, and must not hold itself out to the public as an investment adviser.

### *A. Benefits*

As discussed earlier in this Release, we expect that proposed rule 202(a)(11)(G)–1 would yield several important benefits. First, the proposed rule would result in several benefits for excluded family offices that do not already have an exemptive order. They would not be subject to the costs of registering with the Commission as an investment adviser and its associated compliance costs (or if they were previously registered, they would benefit from the reduced regulatory costs after de-registering in reliance on the exclusion). These reduced regulatory costs should result in direct cost savings to these family offices, and thus to their family clients. Excluded family offices would be able to maintain greater privacy because they would not have to make the public filings with the Commission that they would otherwise have to make as a registered investment adviser.

The proposed rule also would benefit the Commission and family offices that meet the conditions of the proposed rule and their clients by eliminating the costs and inefficiencies of seeking (and considering) individual exemptive orders. As discussed above, family offices that did not qualify for the exemption from registration contained in section 203(b)(3) of the Advisers Act often applied to the Commission for exemptive relief from the Advisers Act. Following the repeal of the exemption contained in section 203(b)(3), we would expect a much greater number of family offices to otherwise apply for exemptive relief absent our rule proposal.[61] We estimate that a typical family office (and thus indirectly their family clients) would incur legal fees of $200,000 on average to engage in the exemptive order application process, including preparation and revision of an application and consultations with Commission staff.[62] The proposed rule would benefit qualifying family offices and their family clients by eliminating the costs of applying to the Commission for an exemptive order to avoid registration and the associated compliance burdens. It also would benefit excluded family offices and their family clients by eliminating the uncertainty that they might not obtain such an order.

The proposed rule also would benefit the Commission by freeing staff resources from reviewing and processing family office exemptive applications that would result from the repeal of section 203(b)(3) of the Advisers Act in many cases where the staff would likely recommend to the Commission that exclusion from regulation under the Advisers Act was appropriate and in the public interest, allowing the staff to target its work more efficiently, and thus would indirectly benefit investors.

We seek comment on whether the elimination of these costs would result in additional benefits to family offices or their clients.

### *B. Costs*

We recognize that there are costs that could result if we adopted our proposed rule. We do not expect that the proposed rule would impose any significant costs on family offices currently operating under a Commission exemptive order. We are permitting these family offices to continue to rely on their exemptive orders and thus would expect them to do so if the costs to do so were lower than complying with the proposed rule. We expect that most of these family offices could satisfy all the conditions of the rule without changing their structure or operations. However, these family offices may incur one-time "learning costs" in determining the differences between their orders and the rule. We expect that such costs would be no more than $5,000 on average for a family office if it hires an external consulting firm or law firm to assist in determining the differences.[63] There are 13 family offices that have obtained exemptive orders. Accordingly, we estimate that these family offices collectively would incur outside consulting or legal expenses of $65,000 to discern the differences between their orders and the rule.

As discussed above, there are a number of family offices that currently are not registered as an investment adviser in reliance on the exemption from registration in section 203(b)(3) of the Advisers Act. The proposed rule would not impose any costs on those advisers because they currently are exempt from registration and thus would have no reason to consider whether they would rather rely on the proposed rule to relieve them of the

[59] 44 U.S.C. 3501 *et seq.*

[60] *See* section 409 of the Dodd-Frank Act.

[61] *See supra* note 3 and accompanying text for industry estimates of the number of single family offices.

[62] This estimate is based on our understanding of typical outside legal fees for past applications.

[63] We expect that a family office would need no more than 10 hours of consulting or legal advice to learn the differences between its order and the rule. We estimate that this advice would cost the family office $500 per hour based on our understanding of the rates typically charged by outside consulting or law firms.

burdens associated with being a registered investment adviser. After July 21, 2010, section 203(b)(3) of the Advisers Act will be repealed and as a result, some of these family offices would be subject to the costs and burdens of registration under the Advisers Act. However, these costs are a consequence of section 403 of the Dodd-Frank Act repealing the section 203(b)(3) exemption, and not this rulemaking. Accordingly, we do not attribute these costs to this rulemaking and thus are not considering them.

We recognize that some family offices may decide to restructure their business to meet the conditions imposed by proposed rule 202(a)(11)(G)–1 so that they would avoid the costs and burdens of registration in reliance on our proposed rule. Some family offices may need to reorganize the ownership or control structure of the family office in order to meet the family office definition under the proposed rule. We estimate that this type of reorganization could be accomplished without significant costs being imposed on the family office because we estimate that most family offices are wholly owned and those that are not only have a small number of non-family members with ownership interests. Other family offices may have to terminate providing investment advice to certain persons because they would not meet the definition of a "family client," which may require these individuals to divest interests in pooled investment vehicles and other entities advised by the family office. The costs of any such restructuring would be highly dependent on the nature and extent of investment of these non-qualifying clients through the family office, which we understand may vary significantly from family office to family office.

Finally, if there were any family offices that previously registered with the Commission, but now may de-register in reliance on the new family office exclusion in the Advisers Act, the proposed rule may have competitive effects on investment advisers that may compete with the family office for the provision of investment management services to family clients since these third party investment advisers would bear the regulatory costs associated with compliance with the Advisers Act or state investment adviser regulatory requirements. We do not expect that the proposed rule would impact capital formation.

We request comment on this analysis. Would family offices that currently rely on an order bear lower costs if they rely on the proposed rule? What amount and types of costs will these family offices bear as a result of the proposed rule? How many family offices are likely to restructure and in what ways? At what cost? What competitive impacts may result if registered family offices de-register if the proposed rule is adopted?

*C. Request for Comment*

The Commission requests comments on all aspects of the cost-benefit analysis, including the accuracy of the potential costs and benefits identified and assessed in this Release, as well as any other costs or benefits that may result from the proposals. We encourage commenters to identify, discuss, analyze, and supply relevant data regarding these or additional costs and benefits. For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[64] the Commission also requests information regarding the potential annual effect of the proposals on the U.S. economy. Commenters are requested to provide empirical data to support their views.

**VI. Initial Regulatory Flexibility Analysis**

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA") regarding proposed rule 202(a)(11)(G)–1 in accordance with section 3(a) of the Regulatory Flexibility Act.[65]

*A. Reasons for Proposed Action*

We are proposing rule 202(a)(11)(G)–1 defining family offices excluded from regulation under the Advisers Act because we are required to do so under Section 409 of the Dodd-Frank Act.

*B. Objectives and Legal Basis*

As described more fully in Sections I and II of this Release, the general objective of proposed rule 202(a)(11)(G)–1 is to define a family office consistent with prior Commission exemptive policy consistent with the Dodd-Frank Act. The Commission is proposing rule 202(a)(11)(G)–1 pursuant to our authority set forth in section 202(a)(11)(G) of the Advisers Act [15 U.S.C. 80b–2(a)(11)(G)].

*C. Small Entities Subject to the Rule*

Under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) Has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had $5 million or more on the last day of its most recent fiscal year.[66]

We do not have data and are not aware of any databases that compile information regarding how many family offices would be a small entity under this definition, but since family offices only are established for the very wealthy and given the statistics noted earlier showing that they generally serve families with at least $100 million or more of investable assets and have an average net worth of $517 million, we believe it is unlikely that any family offices would be small entities.[67]

*D. Reporting, Recordkeeping, and Other Compliance Requirements*

Proposed rule 202(a)(11)(G)–1 would impose no reporting, recordkeeping or other compliance requirements.

*E. Duplicative, Overlapping, or Conflicting Federal Rules*

The Commission has not identified any Federal rules that duplicate, overlap, or conflict with the proposed rule.

*F. Significant Alternatives*

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant impact on small entities. In connection with the proposed rules and amendments, the Commission considered the following alternatives: (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the rule, or any part thereof, for small entities.

[64] Pub. L. 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

[65] 5 U.S.C. 603(a).

[66] 17 CFR 275.0–7(a).

[67] *See supra* note 2 and accompanying text. *See also* The Family Office, *supra* note 2 (finding investable assets of single family offices surveyed ranged from $197 million to $843 million); Family Wealth Alliance, Single-Family Office Study Executive Summary, *available at http://www.fwalliance.com/store/2ndannualsinglefamilystudy.html* (finding assets under management of surveyed single family offices ranged from $51 million to $2.1 billion); Wharton Study, *supra* note 4, at 4 (stating that surveyed single family offices had at least $100 million in investable assets).

Proposed rule 202(a)(11)(G)–1 is exemptive and compliance with the rule would be voluntary. We therefore do not believe that different or simplified compliance, timetable, or reporting requirements, or an exemption from coverage of the proposed rule for small entities would be appropriate. The conditions in the proposed rule are designed to ensure that family offices operating under the rule would only impact the family itself and not the general public and, accordingly, the protections of the Advisers Act are not warranted. Reducing these conditions for smaller family offices would be inconsistent with the policy underlying the exclusion and would harm investor protection.

Our prior exemptive orders have not made any differentiation based on the size of the family office. In addition, as discussed above, we expect that very few, if any, family offices are small entities. The Commission also believes that proposed rule 202(a)(11)(G)–1 would decrease burdens on small entities by making it unnecessary for them to seek an exemptive order from the Commission to operate without registration under the Advisers Act. As a result, we do not anticipate that the potential impact of the proposed rule on small entities would be significant.

The proposed rule specifies broad conditions with which a family office must comply to rely on the exclusion; the proposed rule leaves to each family office how to structure its specific operations to meet these conditions. The proposed rule thus already incorporates performance rather than design standards. For these reasons, alternatives to the proposed rule appear unnecessary and in any event are unlikely to minimize any impact that the proposed rule might have on small entities.

### *G. Solicitation of Comments*

We encourage written comments on matters discussed in this IRFA. In particular, the Commission seeks comment on:

• The number of small entities that would be affected by the proposed rule; and

• Whether the effect of the proposed rule on small entities would be economically significant.

Commenters are asked to describe the nature of any effect and provide empirical data supporting the extent of the effect.

## VII. Statutory Authority

We are proposing rule 202(a)(11)(G)–1 [17 CFR 275.202(a)(11)(G)–1] pursuant to our authority set forth in section 202(a)(11)(G) of the Advisers Act [15 U.S.C. 80b–2(a)(11)(G)].

### List of Subjects in 17 CFR Part 275

Reporting and recordkeeping requirements, Securities.

### Text of Proposed Rule

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows.

## PART 275—RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for Part 275 continues to read in part as follows:

**Authority:** 15 U.S.C. 80b–2(a)(11)(G), 80b–2(a)(17), 80b–3, 80b–4, 80b–4a, 80b–6(4), 80b–6a, and 80b–11, unless otherwise noted.

* * * * *

2. Section 275.202(a)(11)(G)–1 is added to read as follows:

### § 275.202(a)(11)(G)–1 Family offices.

(a) *Exclusion.* A family office, as defined in this section, shall not be considered to be an investment adviser for purpose of the Act.

(b) *Family office.* A family office is a company (including its directors, partners, trustees, and employees acting within the scope of their position or employment) that:

(1) Has no clients other than family clients; provided that if a person that is not a family client becomes a client of the family office as a result of the death of a family member or key employee or other involuntary transfer from a family member or key employee, that person shall be deemed to be a family client for purposes of this § 275.202(a)(11)(G)–1 for four months following the transfer of assets resulting from the involuntary event;

(2) Is wholly owned and controlled (directly or indirectly) by family members; and

(3) Does not hold itself out to the public as an investment adviser.

(c) *Grandfathering.* A family office as defined in paragraph (a) of this section shall not exclude any person, who was not registered or required to be registered under the Act on January 1, 2010, solely because such person provides investment advice to, and was engaged before January 1, 2010 in providing investment advice to:

(1) Natural persons who, at the time of their applicable investment, are officers, directors, or employees of the family office who have invested with the family office before January 1, 2010 and are accredited investors, as defined in Regulation D under the Securities Act of 1933;

(2) Any company owned exclusively and controlled by one or more family members; or

(3) Any investment adviser registered under the Act that provides investment advice to the family office and who identifies investment opportunities to the family office, and invests in such transactions on substantially the same terms as the family office invests, but does not invest in other funds advised by the family office, and whose assets as to which the family office directly or indirectly provides investment advice represents, in the aggregate, not more than 5 percent of the value of the total assets as to which the family office provides investment advice; provided that a family office that would not be a family office but for this paragraph (c) shall be deemed to be an investment adviser for purposes of paragraphs (1), (2) and (4) of section 206 of the Act.

(d) *Definitions.* For purposes of this section:

(1) *Control* means 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.*

(2) *Family client* means:

(i) Any family member;

(ii) Any key employee;

(iii) Any charitable foundation, charitable organization, or charitable trust, in each case established and funded exclusively by one or more family members or former family members;

(iv) Any trust or estate existing for the sole benefit of one or more family clients;

(v) Any limited liability company, partnership, corporation, or other entity wholly owned and controlled (directly or indirectly) exclusively by, and operated for the sole benefit of, one or more family clients; provided that if any such entity is a pooled investment vehicle, it is excepted from the definition of "investment company" under the Investment Company Act of 1940;

(vi) Any former family member, provided that from and after becoming a former family member the individual shall not receive investment advice from the family office (or invest additional assets with a family office-advised trust, foundation or entity) other than with respect to assets advised (directly or indirectly) by the family office immediately prior to the time that the individual became a former family member, except that a former family member shall be permitted to receive investment advice from the family office with respect to additional investments that the former family member was contractually obligated to make, and that relate to a family-office advised investment existing, in each case prior to the time the person became a former family member; or

(vii) Any former key employee, provided that upon the end of such individual's employment by the family office, the former key employee shall not receive investment advice from the family office (or invest additional assets with a family office-advised trust, foundation or entity) other than with respect to assets advised (directly or indirectly) by the family office immediately prior to the end of such individual's employment, except that a former key employee shall be permitted to receive investment advice from the family office with respect to additional investments that the former key employee was contractually obligated to make, and that relate to a family-office advised investment existing, in each case prior to the time the person became a former key employee.

(3) *Family member* means:

(i) The founders, their lineal descendants (including by adoption and stepchildren), and such lineal descendants' spouses or spousal equivalents;

(ii) The parents of the founders; and

(iii) The siblings of the founders and such siblings' spouses or spousal equivalents and their lineal descendants (including by adoption and stepchildren) and such lineal descendants' spouses or spousal equivalents.

(4) *Former family member* means a spouse, spousal equivalent, or stepchild that was a family member but is no longer a family member due to a divorce or other similar event.

(5) *Founders* 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.

(6) *Key employee* means any natural person (including any person who holds a joint, community property, or other similar shared ownership interest with that person's spouse or spousal equivalent) who is an executive officer, director, trustee, general partner, or person serving in a similar capacity of the family office or any employee of the family office (other than an employee performing solely clerical, secretarial, or administrative functions with regard to the family office) who, in connection with his or her regular functions or duties, participates in the investment activities of the family office, provided that such employee has been performing such functions and duties for or on behalf of the family office, or substantially similar functions or duties for or on behalf of another company, for at least 12 months.

(7) *Spousal equivalent* means a cohabitant occupying a relationship generally equivalent to that of a spouse.

Dated: October 12, 2010.

By the Commission.

**Elizabeth M. Murphy,**

*Secretary.*

[FR Doc. 2010–26086 Filed 10–15–10; 8:45 am]

**BILLING CODE 8011–01–P**

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## DEPARTMENT OF EDUCATION

### 34 CFR Part 668

**RIN 1840–AD04**

**[Docket ID ED–2010–OPE–0012]**

## Program Integrity: Gainful Employment

**AGENCY:** Office of Postsecondary Education, Department of Education.

**ACTION:** Notice of public meeting sessions.

**SUMMARY:** The Secretary of Education (Secretary) announces public meeting sessions to receive oral presentations and to interact with commenters regarding comments that were submitted to the Department of Education in response to its Notice of Proposed Rulemaking on Program Integrity: Gainful Employment, published in the **Federal Register** on July 26, 2010 (75 FR 43616).

**DATES:** The public meeting sessions will be held on the dates and at the locations specified later in this document.

**FOR FURTHER INFORMATION CONTACT:** Leigh Arsenault, U.S. Department of Education, 400 Maryland Avenue, SW., Room 7E304, Washington, DC 20202. Telephone: 202–453–7127 or by e-mail: *Leigh.Arsenault@ed.gov.*

If you use a telecommunications device for the deaf (TDD), call the Federal Relay Service (FRS), toll free, at 1–800–877–8339.

**SUPPLEMENTARY INFORMATION:** On July 26, 2010, the Department published a notice of proposed rulemaking (NPRM) in the **Federal Register** proposing regulations for determining whether a postsecondary educational program provides training that leads to gainful employment in a recognized occupation and the conditions under which such a program would remain eligible for the student financial assistance programs authorized under title IV of the Higher Education Act of 1965, as amended (HEA). Comments on the Department's proposed regulations were due on September 9, 2010. The Department received over 90,000 comments from a wide range of stakeholders, including for-profit universities and colleges, community colleges, students, higher education associations, members of Congress, financial analysts, economists, and college and university faculty.

The Department appreciates the tremendous feedback, both positive and negative, that it received on the proposed regulations. The response from so many individuals and entities demonstrates how important the issues relating to gainful employment and this rulemaking are. To better understand parties' comments and have an opportunity to interact with commenters, the Department will hold four public meeting sessions over the course of two days. During this time, commenters who have timely submitted comments on the NPRM may orally present their comments to a panel of Department representatives. Commenters also may have an opportunity to respond to questions from the Department about their comments.

### Public Meeting Dates, Times, Locations, and Registration Information

The four public meeting sessions will be held on the following dates and times at the U.S. Department of Education, Barnard Auditorium, 400 Maryland Avenue, SW., Washington, DC 20202.

*Session 1:* November 4, 2010, from 9 a.m. to 12 p.m.

*Session 2:* November 4, 2010, from 1 p.m. to 4:30 p.m.

*Session 3:* November 5, 2010, from 9 a.m. to 12 p.m.

*Session 4:* November 5, 2010, from 1 p.m. to 4:30 p.m.

*Oral Presentations From Commenters*

Oral presentations at the public meeting sessions will be limited only to individuals or entities that timely submitted comments on the NPRM and only to the comments the commenter submitted. No new topics or concerns may be introduced. Each commenter who is interested in making an oral presentation of comments on the NPRM will be allowed a total of five minutes. The Department will not accept any written materials from any presenter or other individual or entity attending the public meeting sessions.

If you are interested in making an oral presentation of your comments at one of the public meeting sessions, you must register at *http://usdoedregistration.ed.gov/profile/web/index.cfm?PKwebID=0x3626e49.* We will accept registrations at this Web site, beginning at 12 noon, Washington, DC