

CARTER LEDYARD & MILBURN LLP
Counselors at Law

Mary Joan Hoene
Counsel

Direct Dial: 212-238-8791
E-mail: hoene@clm.com

2 Wall Street
New York, NY 10005-2072

Tel (212) 732-3200
Fax (212) 732-3232

570 Lexington Avenue
New York, NY 10022-6856
(212) 371-2720

April 24, 2012

BY EMAIL

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Regulation 4.5 Harmonization

Dear Mr. Stawick:

We represent the Guilford Company (“Guilford”), a single family office¹, and submit this letter to request that the Commodity Futures Trading Commission (the “Commission”) adopt an exclusion for single family offices from the commodity “pool” definition, thereby excluding operators from commodity pool operator (“CPO”) registration, and further adopt an exemption from commodity trading advisor (“CTA”) registration for single family offices (jointly, the “Family Office Exclusion”).

Introduction

The Commission recently adopted final rules (the “Final Rules”) that repeal the exemption from CPO registration under Rule 4. 13(a)(4) and the accompanying exemption from CTA registration under Rule 4. 14(a)(8)(i)(D)². Also, the Commission has expressly encouraged family offices to rely on previously issued staff interpretative letters (or seek similar relief), and formally asked for public comment on whether it should adopt a Family Office Exclusion.³ The

¹ “Family offices” are entities established by wealthy families to manage their wealth and provide other services to family members. See the Investment Advisers Act Release No. 3098 (Oct. 12, 2010), [75 Fed. Reg. 63753 (Oct. 18, 2010)] (“Proposing Release”).

² Commodity Pool Operators and Commodity Trading Advisers Compliance Obligations, 77 Fed. Reg. 11252 (Feb. 24, 2012).

³ Id., page 11263 and footnote 125; Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators, 77 Fed. Reg. 11345, 11348 (Feb. 24, 2012).

Commission staff has a 36-year history of granting family office interpretative, exemptive and no-action relief from CPO and/or CTA registration, demonstrating that the operation of a family office is not the kind of activity that Congress and the Commission intended to regulate through CPO and/or CTA registration requirements.

Guilford believes that requiring family offices to register as CPOs and/or CTAs as a result of the repeal of Rule 4. 13(a)(4) and the amendment to Rule 4. 14(a)(8)(i)(D) in the Final Rules is unwarranted and unnecessary. Codifying previously issued relief letters into a Family Office Exclusion would efficiently ensure that all family offices will now receive consistent treatment under the Commission's regulations. A Family Office Exclusion would also assist congruency of regulation of family offices as between the Commission and the U.S. Securities and Exchange Commission ("SEC"), and align the Commission's treatment of family offices with the congressional intent of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Pub. L. 111-203 (2010).⁴

A Family Office Exclusion based upon the previously issued staff interpretative, exemptive and no-action relief letters should employ the framework the SEC developed in adopting a family office exclusion from the definition of "investment adviser" in the Investment Advisers Act of 1940 ("Advisers Act"), under Rule 202(a)(11)(G)-1 (the "SEC Family Office Rule"). Family clients, as defined in the SEC Family Office Rule, should be excluded from the definition of commodity "pool" in Rule 4.1 O(d)(l), which thereby would exclude the operators of such entities from registering with the Commission as CPOs. The family offices themselves, as defined in the SEC Family Office Rule, should be excluded under Rule 4.14 from registering with the Commission as CTAs in connection with commodity interest trading advice provided to family clients. We also suggest two important additional accommodations (discussed in Section E. below) that would make the exclusion more viable for family offices.

A. Family Offices

A family office is an organization that is wholly-owned by family clients and is exclusively controlled (directly or indirectly) by one or more family members and/or family entities. A family office's clientele varies based upon the family it represents, but in general, the office is limited to family members (including certain former family members), trusts for their benefit and other affiliated entities, and key employees, members of key employees' families, and their affiliated entities.

The services family offices provide vary. In proposing the SEC Family Office Rule, the SEC stated that a family office's services "typically include managing securities portfolios, providing personalized financial, tax, and estate planning advice, providing accounting services,

⁴ Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. 7976, 7978 (Feb. 11, 2011). In its proposing release to amend the compliance obligations of CPOs and CTAs, the Commission stated that the "proposed amendments are designed to (1) bring the Commission's CPO and CTA regulatory structure into alignment with the stated purposes of the Dodd-Frank Act; (2) encourage more congruent and consistent regulation of similarly-situated entities among Federal financial regulatory agencies ... " *Id.*

and directing charitable giving, in each case to members of a family.⁵ Family offices typically make extensive use of trusts for a variety of reasons. To provide these services, family offices usually hire professional staff, most of whom are not family members. Professional staff can include attorneys, accountants, administrators and investment professionals, among others, each of whom generally receives compensation, pension and employee benefit plans comparable to other private employers.

Family offices advise family members and their entities with respect to exchange-traded and other publicly-listed securities, hedge funds, private equity, venture capital, real estate, and other funds, and other assets. Family offices often establish partnerships or LLCs in which only family clients and key employees can invest. Many family offices may also use, directly or indirectly, commodity interests and direct investments in commodities as part of their investment program. Family offices are generally considered to be “institutional investors” by financial market participants.

B. CPO and CTA Registration Was Not Intended for Family Offices.

The legislative history of the Commodity Exchange Act (“CEA”) indicates that CPO and CTA registration requirements were intended to protect potential customers or investors from unscrupulous practices.⁶ The requirements in Part 4 of the Commission’s regulations have been designed to “expose and thus help to circumscribe the undesirable business practices” with respect to CPOs and to “specifically eliminate certain undesirable practices which have enticed unsuspecting [clients] into the markets” with respect to CTAs.⁷ These types of customer protection concerns are simply not germane to family offices.

A family office is wholly owned by family clients and is exclusively controlled (directly or indirectly) by one or more family members and/or family entities. Family offices do not market or sell products to consumers or investors. The absence of consumer protection-related concerns is fundamental to the Commission staff’s interpretative, exemptive and no-action letters. These positions are based on the premise that the operation of family entities is not the type of activity that either Congress or the Commission intended to regulate as “CPOs” and “pools,” respectively.⁸ This same rationale underlies Congress’ judgment that there is no federal interest in applying the Advisers Act to family offices.⁹

⁵ 75 Fed. Reg. at 63754 (Oct 18 2010).

⁶ See Proposed Comprehensive Scheme for Regulation, 42 Fed. Reg. 9266 (Feb 15, 1977); Proposed Comprehensive Scheme for Regulation, 42 Fed. Reg. 9278 (Feb 15, 1977).

⁷ *Id.*

⁸ E.g., CFTC Interpretative Letter No., 00-98, Comm. Fut. L. Rept. (CCH) ¶28,411 (May 22, 2000) (“... it appears that the operation of the [family investment entities] is not the kind of activity Congress and the Commission intended to regulate in adopting the CPO and pool definitions, respectively”).

⁹ S. Conf. Rep. No. 111-176, at 75 (2010). A colloquy on Section 409 of the Dodd-Frank Act between two of the Chairman of Committees of jurisdiction on the bill, Senators Lincoln and Dodd, made even clearer the lack of federal interest: “For many decades, family offices have managed money for members of individual families, and they do not pose systemic risk or any other regulatory issues. The SEC has provided exemptive relief to some family offices in the past, but many family offices have simply relied on the ‘under 15 clients’ exception to the Investment Advisers Act, and when

C. Family Offices Would Remain Subject to Other Key Market-Related Requirements.

Relief from CPO and/or CTA registration requirements does not excuse an entity from compliance with any other applicable requirements of the CEA or in the Commission's regulations.¹⁰ Staff interpretative letters have stated that excluded family offices would remain subject to the antifraud provisions of the CEA as well as the reporting requirements set forth in Parts 15, 18, and 19 of the Commission's regulations.¹¹ A codified Family Office Exclusion would operate no differently. The Commission will retain ample authority to enforce its statutory mandate of protecting the commodities markets and those who invest and trade on those markets.

The Commission's large trader reporting system collects daily information from clearing members, futures commission merchants and traders, allowing the Commission to develop a comprehensive view of activity by large market participants.¹² If a large market participant accumulates a "reportable position," it may be required to file the Commission's more detailed Form 40. An excluded family office would remain subject to the full spectrum of these Commission large trader reporting requirements.

Congress has also created numerous additional regulatory requirements with respect to swap transactions to which excluded family offices would be subject. For example, swap transactions would still be subject to clearing and exchange-trading requirements, reporting and recordkeeping requirements and initial and variation margin requirements. Additionally, an excluded family office would remain subject to the major swap participant and major security-based swap participant registration requirements, if applicable.

Accordingly, we believe that no regulatory gap is created by adopting a Family Office Exclusion.

D. Systemic Risk Considerations

In the adopting release to the Final Rules, the Commission notes it does not have a comprehensive view of family offices and claims that it is "essential" to the adoption of a generally applicable Family Office Exclusion to collect additional information from non-excluded family offices through the Commission's recently adopted systemic risk reporting

Congress eliminated this exception, it was not our intent to include family offices in the bill." 156 Congo Rec. S5904 (daily ed. July 15,2010).

¹⁰ See, e.g., CFTC Staff Letter No. 10-25, Comm. Fut. L. Rept. (CCH) ¶31,585 (Jun. 25, 2010) ("This letter does not excuse "[its recipient] from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, [the recipient] remains subject to the antifraud provisions of Section 4b of the Act and the reporting requirements set forth in Parts 15, 18, and 19 of the Commission's regulations").

¹¹ *Id.*

¹² The Commission's website states that "The aggregate of all large trader positions reported to the Commission usually represents 70 to 90 percent of the total open interest in any given market." available at: <http://www.cftc.gov/IndustryOversight/MarketSurveillance/LargeTraderReportingProgram/index.htm>.

forms.¹³ It is unclear how the Commission's systemic risk forms could facilitate the Commission's adoption of a Family Office Exclusion. The forms do not allow for the Commission to identify family office filers as opposed to all other filers.¹⁴ Even if the Commission could identify the family offices, the forms would not provide the Commission with any information about the relationships among investors in the family investment entities, which is the determinative factor in granting relief to family offices. Even assuming a particular family office were subject to the systemic risk reporting requirement, the Commission has explicitly invited such family offices to request letter-based relief and thereby remove themselves from the Commission's systemic risk reporting requirement. It thus appears that the Commission's systemic risk reporting forms are not essential, and likely would not even be helpful, to the Commission when evaluating a Family Office Exclusion.

E. What Should a Family Office Exclusion Cover?

To ensure consistent and more cost-effective regulation of family offices between the Commission and the SEC, a Family Office Exclusion should start with the framework the SEC adopted in its family office exclusion in the Advisers Act. The Commission should create a definitional exclusion for "family clients" instead of an exemption from CPO registration because a definitional exclusion is more consistent with the staffs' historical treatment of family investment entities and the SEC's treatment of family offices. The starting point should be to exclude "family clients," as defined in the SEC Family Office Rule,¹⁵ from the definition of commodity "pool" in Rule 4.10(d)(1).¹⁶ Such a "family office," would not have to register as a CPO with respect to its operation of family clients.¹⁷ Likewise, the Commission should adopt an exemption from CTA registration for family offices because it is also generally consistent with the staffs' previously-issued letter-based relief. This can be addressed by adding a new paragraph to Rule 4.14,¹⁸ to provide a self-executing exemption from CTA registration for

¹³ 77 Fed. Reg. at 11263

¹⁴ Without the ability to distinguish between filers, it does not appear that the Commission could isolate family office forms such that it could conduct "an analysis of data regarding [family office] activities." *Id.*

¹⁵ 17 C.F.R. § 275.202(a)(11)(G)-1(d)(4).

¹⁶ Although the Dodd-Frank Act amended the CEA to include a statutory definition of "commodity pool," that statutory definition provides the Commission with express authority to "exclude from the term 'commodity pool' any investment trust, syndicate, or similar form of enterprise..." *See* Dodd-Frank Act, § 721; 7 U.S.C. 1a(10).

¹⁷ *See, e.g.*, CFTC Interpretative Letter No. 95-18, Comm. Fut. L. Rept. (CCH) ¶26,345 (Mar. 3, 1995) ("...the Partnership is not a pool within the meaning and intent of Rule 4.10(d), and therefore, no general partner thereof is a CPO"); CFTC Interpretative Letter No. 95-21, Comm. Fut. L. Rept. (CCH) ¶26,348 (Mar. 7, 1995) ("...the Partnership is not a 'pool' within the meaning and intent of Rule 4.10(d) and...none of the Partnership's partners is a CPO thereof"); CFTC Interpretative Letter No. 95-55, Comm. Fut. L. Rept. (CCH) ¶26,424 (Apr. 28, 1995) ("...neither the Partnership nor the Company is a 'pool' within the meaning and intent of Rule 4.10(d) and...neither the General Partner nor the managers of the Company are CPOs thereof"); CFTC Interpretative Letter No. 96-24, Comm. Fut. L. Rept. (CCH) ¶26,653 (Mar. 4, 1996) ("... [a partnership composed of family members] is not a 'pool' within the meaning and intent of Rule 4.10(d)(1) and, consequently, [its general partner] is not a CPO thereof).

¹⁸ An exclusion from the definition of the term "pool" would address the family office's CPO registration requirements, not its CTA registration requirements. Because the family office would be definitionally excluded from CPO status, it could not rely on the existing exemption from CTA registration in Rule 4.14(a)(5). 17 C.F.R. § 4.14(a)(5).

family offices with respect to commodity interest trading advice that is directed solely to, and for the sole use of, persons defined as family clients.

Further, the Commission should make reasonable accommodations for two types of family clients omitted from the SEC's "family client" definition. First, the Commission should recognize the immediate in-laws of family members' spouses as "family clients."¹⁹ The SEC's definition of "family client" includes the spouse of the founder of the family office and the spouses of his or her lineal descendants, but does not include any of the in-laws related through these spouses or their lineal descendants. For example, in order to rely on the exclusion, the founder of a family office could not allow his or her spouse's parents' assets to be supervised by the family office. This definition of "family client" is unduly restrictive and would result in a Family Office Exclusion that is narrower in scope than staff's interpretative, exemptive and no-action relief.²⁰ Therefore, the Commission's Family Office Exclusion should allow family offices to supervise the investments of immediate in-laws of family clients and descendants.

Second, the Commission should include language that recognizes certain trusts of key employees as family clients. The SEC's definition of "family client" includes a trust established by a key employee for the benefit of his family, but only if two conditions are satisfied.²¹ Each settlor or other person who has contributed assets to the trust must be a key employee (or, in certain instances, the key employee's spouse),²² and each trustee or other person authorized to make decisions with respect to the trust must be a key employee.²³ This latter requirement defeats the key employee's estate tax planning because, if the key employee retains certain powers over the trust (as trustee or otherwise), the key employee will not be considered to have surrendered control over the asset transferred to the trust and, as a result, the assets in the trust will be includible in his estate for estate tax purposes.²⁴ By making reasonable and practical accommodations with respect to the trustees of these key employee trusts, the Commission's Family Office Exclusion will better reflect the realities of estate tax planning.

As part of its statutory mandate, "[t]he Commission is authorized to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this chapter." 7 U.S.C. § 12a(5). Guilford submits that the Commission would fulfill its statutory responsibilities by adopting a Family Office Exclusion as discussed above. Relief for family offices would not compromise investor protection or the Commission's market regulation program. In the absence of relief, inapposite regulation will impose significant costs and unintended consequences on family offices, with no commensurate benefit to our financial

¹⁹ Immediate in-laws mean any mother-in-law, father-in-law, sister-in-law, brother-in-law, daughter-in-law or son-in-law of family clients (as defined in Rule 202(a)(11)(G)-1(d)(4) under the Advisers Act) and their lineal descendants.

²⁰ See, e.g., CFTC Interpretative Letter No. 95-21, Comm. Fut. L. Rept. (CCH) ¶26,348 (Mar. 7, 1995) (granting "not-a-pool" relief to a partnership including a son-in-law).

²¹ 17 C.F.R. § 275.202(a)(11)(G)-1(d)(4)(x)

²² *Id.*

²³ *Id.*

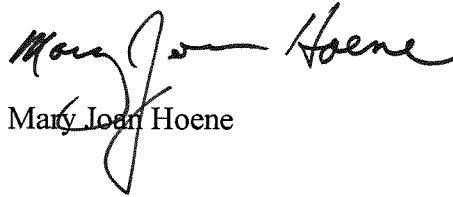
²⁴ Section 2036 of the Internal Revenue Code.

markets or the investing public. A Family Office Exclusion could be fashioned, proposed and adopted relatively quickly, thus enabling the Commission to avoid the processing of numerous specialized requests for relief from individual family offices. Commission and family office resources each would be efficiently utilized in such an effort.

* * *

Guilford appreciates the opportunity to support the Commission's consideration of a Family Office Exclusion. We would be happy to answer any questions the Commission or its staff might have.

Sincerely,



Mary Joan Hoene

MJH:crs

cc: James R. Landrigan, CFA, CIO
Jerome J. Caulfield, Esq.