

## **SPEECHES & TESTIMONY**

### **Dissenting Statement of Commissioner Dan M. Berkovitz**

#### **Rulemaking to Provide Exemptive Relief for Family Office CPOs: Customer Protection Should be More Important than Relief for Billionaires**

**November 25, 2019**

I dissent from today's final rule to provide registration exemptions for operators of commodity pools in large investment management structures euphemistically called "family offices." These investment management structures typically manage hundreds of millions, sometimes billions, of dollars, in private wealth. The regulations that we proposed last year (Proposal) balanced the family office exemption with an annual notice filing requirement and a prohibition on persons who were statutorily disqualified from operating commodity pools from claiming the exemption.<sup>[1]</sup> Today's final rule provides a blanket exemption for the operators of commodity pools (CPOs) in family offices without either of these minimal checks and balances. It is absurd that the Commission is excusing billionaires from the notice-filing requirement that generally applies to other persons—who have a fraction of that immense wealth—who claim exemptions from CPO registration.<sup>[2]</sup> And persons that are statutorily disqualified from registering should not be permitted to operate under an exemption from registration. Disqualified persons should be disqualified.

#### **Family Office Registration Exemption**

The final rule exempts CPOs and commodity trading advisors (CTAs) from registration requirements in connection with commodity pools that are solely for the use of entities that are called "family offices."

##### *"Family Offices" Are Very Large Enterprises*

According to the Securities and Exchange Commission ("SEC"), whose definition of "family office" is used in today's rulemaking, "Family offices' are entities established by wealthy families to manage their wealth and provide other services to family members, such as tax and estate planning services."<sup>[3]</sup> Family offices, however, are not and have never been used by ordinary families who may have a modest degree of wealth, but rather by the extraordinarily wealthy—including royalty, aristocrats, and wealthy entrepreneurs, bankers and hedge fund operators—who create these organizations to preserve, grow, and pass on their wealth to their descendants.<sup>[4]</sup> Under the SEC's definition, family offices are not limited to managing the wealth of the related members of a family, but may also include "family clients," which includes key employees of the family office, any non-profit or charitable organization funded exclusively by family members, certain family client trusts, and any company wholly-owned by and operated for the sole benefit of family clients.<sup>[5]</sup>

By any measure, family offices today manage extremely large amounts of wealth. According to the Global Family Office Report 2019, "[t]he average family wealth of those surveyed for this report stands at USD 1.2 billion, while the average family office has USD 917 million in [assets under management]."<sup>[6]</sup> Another source reports that, as of 2014, "of the 34 family offices surveyed, the financial size of the office ranged from \$42 million to well over \$1.5 billion, with a median of \$275 million assets under supervision and a mean of \$516 million."<sup>[7]</sup> Although there remain family offices with tens of millions of dollars in assets under management, over the past decade the costs of running a family office have increased significantly. It is now estimated "that the operating costs to build out a fully functioning family office typically require a minimum in the range of \$500 million to \$1 billion."<sup>[8]</sup>

The aggregate amount of wealth managed by family offices is staggering. By one estimate, the total assets under management by family offices is over \$4 trillion, and the number of family offices has grown ten-fold in the last decade.<sup>[9]</sup> A recent Forbes article noted that "[f]amily offices are now capable of making transactions that were traditionally reserved for big companies or private-equity firms and therefore are becoming a *disruptive force in the market-place*."<sup>[10]</sup>

## *The Family Office Exemption*

As explained in both the Proposal and today's final rule, family offices typically have been exempt from CPO registration. When the previous regulation that family offices relied upon for an exemption was repealed in 2012, the Commission provided no-action relief to enable family offices to continue to be exempt from registration. Family offices are currently operating on an exempt basis under this no-action relief.

The rationale for providing registration relief to pools investing the money of family members has merit. The commodity pool regulatory regime is in significant part directed at those who solicit funds for the pools and preventing investor fraud and misuse of customer funds. Presumably, these concerns are less likely to arise if a pool is an investment vehicle for investors who are related to each other and do not solicit funds from the general public.<sup>[11]</sup> I voted for the Proposal to seek comments on making permanent the no-action relief from registration currently available to family office pool operators.

### *Family Offices Are Currently Required to Provide Notice for a CPO Exemption*

But whereas the Proposal included sensible initial and annual notice filing requirements for an exempt CPO that would notify the Commission that it is electing the exemption, the final rule eliminates that requirement. To date, family office CPOs claiming an exemption from registration has been required to provide notice to the CFTC of their claim for exemption. The current no-action relief imposes a notice requirement,<sup>[12]</sup> as did the previous regulatory exemption that was relied upon by family office CPOs prior to its repeal in 2012.<sup>[13]</sup> Neither of these notice requirements placed any significant burdens or costs upon family office CPOs.<sup>[14]</sup>

The Proposal would have subjected persons claiming an exemption from CPO registration to the same notice requirements that apply to other types of CPOs claiming an exemption from registration under Regulation 4.13. Under Regulation 4.13, a person claiming any of the enumerated exemptions from CPO registration is required to provide his or her name, address, telephone number, fax number, and email address, and the name of the pool for which it is claiming the exemption.<sup>[15]</sup> In the Proposal the Commission estimated that the notice filing would cost approximately \$28.50 per pool annually.<sup>[16]</sup>

The estimated \$28.50 annual cost of filing a notice of claim of exemption is trivial compared to the hundreds of millions of dollars managed by the average family office CPO. All other types of CPOs claiming an exemption under Regulation 4.13, such as operators of single pools without compensation, or operators of small pools with less than \$400,000 in capital, are required to file the same notice of a claim of exemption. There is no rational justification for exempting large family office pools with hundreds of millions of dollars, or in many cases billions of dollars, under management from the minimal notice requirements that apply to other, less wealthy persons claiming exemptions from CPO registration.

The CFTC's interest in commodity pool operators is not limited to the protection of investors in the pool. The Commission has a significant interest in how the activities of these pool operators may affect the commodity markets. Congress has declared in section 4I of the Commodity Exchange Act (CEA) that "the activities of commodity trading advisors and commodity pool operators are affected with a national public interest in that, among other things . . . their operations are directed toward and cause the purchase and sale of commodities for future delivery . . . and the foregoing transactions occur in such volume as to affect substantially transactions on contract markets . . . ."<sup>[17]</sup> The Commission has a significant interest in knowing the identity of the persons that operate these pools, including those that are exempt from registration. This significant interest is manifested in the Commission's requirement that all other exempt CPOs provide the Commission with annual notices claiming or affirming their exemption from registration. The Commission's interest in the activities of large, multimillion dollar family pool CPOs is certainly no less than the Commission's interest in the activities of smaller CPOs, all of which are required to provide annual notice when they claim an exemption from registration.

The Commission eliminates the notice requirement largely on the basis that this will harmonize the Commission's regulations with those of the SEC. Harmonization for harmonization's sake is not a rational basis for agency action. The question for the CFTC is not whether the SEC has determined whether a notice requirement is appropriate, but rather whether the CFTC would benefit from a notice requirement under the CFTC's system of regulations. To the extent that the Commission believes it has no regulatory interest in the operation of commodity pools beyond the protection of investors in the pool, such a belief is manifestly wrong and inconsistent with Congress's finding in CEA section 4I. The Commission has a significant regulatory interest in knowing the identity of CPOs that may be "a disruptive force in the market-place."<sup>[18]</sup> The Commission's mission would be better served by harmonizing the family pool CPO exemption process with its own regulations for exempt CPOs rather than the SEC's regulations.

## Disqualification of Disqualified Persons

The Proposal would have prohibited any person who was subject to a statutory disqualification from registration from claiming an exemption from registration. The logic underlying this provision is simple: a person who is disqualified from operating a commodity pool in a registered capacity should also be disqualified from operating a pool in an unregistered capacity. Disqualified persons should be disqualified. In the Proposal the Commission stated:

The Commission is concerned that it poses undue risk from a customer protection standpoint regulations in their current form to permit statutorily disqualified persons or entities to legally operate exempt commodity pools, especially when those same persons would not be permitted to register with the Commission. The Commission preliminarily believes that preserving the prohibitive statutory disqualifications from Advisory 18-96 and applying it to exemptions under §4.13 will provide a substantial customer protection benefit by prohibiting statutorily disqualified persons operating and soliciting participants for investment in exempt commodity pools.<sup>[19]</sup>

The National Futures Association (NFA) submitted a comment letter "fully support[ing]" the disqualification of disqualified persons. NFA stated:

[T]he Commission aptly states in the *Federal Register* release that the proposed prohibition will provide a substantial customer protection benefit. In particular, the proposed change addresses a significant regulatory gap in the Commission's exemption framework and will certainly strengthen customer protection by ensuring that a person who may be prohibited from registering as a CPO is not able to operate an exempt fund outside of the Commission's and NFA's regulatory oversight.

In today's final rule the Commission states that commenters raised a number of issues regarding the statutory disqualification proposal that require further consideration. I agree that the Commission should address these comments. But it should have done so prior to granting today's exemptions from registration. Customer protection should be our first priority, and not deferred indefinitely. The Commission should have addressed these comments and finalized the disqualification rule prior to granting today's exemption for family offices. Customer protection should not take a back seat to exemptions from regulations for billionaires.

The approval of this rule without any checks and balances on exempt family office CPOs will increase risks to our markets and market participants. I therefore dissent.

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<sup>[1]</sup> Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors, Notice of proposed rulemaking, 83 Fed. Reg. 52902 (Oct. 18, 2018).

<sup>[2]</sup> See 17 C.F.R. 4.13(b).

<sup>[3]</sup> SEC, *SEC Adopts Rule Under Dodd-Frank Defining "Family Offices"* (June 22, 2011), available at [sec.gov/news/press/2011-134.htm](http://sec.gov/news/press/2011-134.htm).

<sup>[4]</sup> According to one guide to family offices:

Family offices have their roots in the sixth century, when a king's steward was responsible for managing royal wealth. Later on, the aristocracy also called on this service from the steward, creating the concept of stewardship that still exists today. But the modern concept of the family office developed in the 19th century. In 1838, the family of financier and art collector J.P. Morgan founded the House of Morgan to manage the family assets. In 1882, the Rockefellers founded their own family office, which is still in existence and provides services to other families.

EY Family Office Guide, *Pathway to successful family and wealth management*, at 4, available at [https://www.ey.com/en\\_us/tax/family-office-advisory-services](https://www.ey.com/en_us/tax/family-office-advisory-services).

[5] 17 C.F.R. 275.202(a)(11)(G)-1. Under the SEC's definition, the term "family member" is quite broad. "Family member means all lineal descendants . . . of a common ancestor (who may be living or deceased), and such lineal descendants' spouses or spousal equivalents; provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members." 17 C.F.R. 275.202(a)(11)(G)-1(d)(6).

[6] Campden Research and UBS, *The Global Family Office Report 2019*, at 10, available at: [https://www.ey.com/en\\_us/tax/family-office-advisory-services](https://www.ey.com/en_us/tax/family-office-advisory-services).

[7] Kirby Rosplock, *The Complete Family Office Handbook, A Guide for Affluent Families and the Advisors Who Serve Them*, at 8 (Wiley, Bloomberg Press, 2014).

[8] *Id.*

[9] Francois Botha, *The Rise of the Family Office: Where Do They Go Beyond 2019?*, *Forbes* (Dec. 17, 2018), available at <https://www.forbes.com/sites/francoisbotha/2018/12/17/the-rise-of-the-family-office-where-do-they-go-beyond-2019/#426044f55795>.

[10] *Id.* (emphasis added).

[11] However, affinity fraud, including defrauding relatives, is not unheard of. See, e.g., Consent Order, *CFTC v. Carter*, No. 18-cv-242, 2018 WL 7140335 (N. D. Ill. Nov. 13, 2018) and Complaint, *CFTC v. Williams*, No. 2:17-cv-01325, 2017 WL 1755463 (D. Ariz. May 3, 2017).

[12] CFTC Letter No. 12-37, at 2-3 (Nov. 29, 2012), available at <https://www.cftc.gov/idc/groups/public/@lrllettergeneral/documents/letter/12-37.pdf>.

[13] 17 C.F.R. 4.13(b) (2011).

[14] Under the current no-action relief, a person claiming the exemption must provide the claimant's name, business address, and telephone number, state the capacity (i.e., CPO) and name of the pool for which the claim is being filed, and be electronically signed by the CPO. CFTC Letter No. 12-37, at 2-3.

[15] 17 C.F.R. 4.13(b)(1) (2019).

[16] Proposal, at 52923. Based on the notices filed under the CFTC No Action Letter 12-37, the Commission estimated that approximately 200 CPOs would be affected, with an average of 3 pools each that would be subject to the notice requirement. *Id.*

[17] 7 U.S.C. 6l.

[18] See *supra* note 10.

[19] Proposal, at 52906.

[20] Letter from Carol Wooding, Vice President, General Counsel and Secretary, National Futures Association, to Christopher J. Kirkpatrick, Secretary of the Commission, Re: RIN 3038-AE76: Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors (Dec. 17, 2018).