Sweetwater Investments, Inc.

July 10, 2009
Ms Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F. Street NE
Washington, DC 20549-1090

TRANSMITTED VIA EMAIL
RE: File number S7-09-09

Background

I am the President and Chief Compliance Officer of Sweetwater Investments. We are registered with the Commission (File number 801-35176) and have been an RIA for 20 years. I have been associated with the securities industry since 1973. Our primary clientele are individual investors ranging in age from 35 to 80. A majority of our clients (61%) are women or female controlled households.

Due to the nature of our clientele we deal on a daily basis with issues of trust, credibility and the fiduciary standard. There can be no doubt the cases cited in the proposed rule making as well as those which have garnered disproportionate headlines (Madoff, Sanford) have shaken the public's trust in providers of financial advice as well as those appointed to regulate advisors. It is therefore not unreasonable that the Commission would use its mandate to emplace methods to restore trust. However well intended and rigorous, restoration of trust will not come quickly. The Commission and other agencies supervising the financial markets should exercise prudence in rule making to avoid knee jerk reactions that might appear to be warranted but contain dangerous seeds for further distortions.

The proposed rule making focuses on several areas of which three are of immediate concern to my firm:

I. Custody

Frankly, I have never understood the rationale behind the Commission' s assertion that the ability to withdraw fees earned as a result of discretionary management of assets held at a third party custodian constitutes custody. I do understand the concerns surrounding such withdrawals in the case of related party custodians or pooled investment vehicles.

This firm with draws its fees from client accounts for two reasons:

1. Under GIPS performance standards cash flows in and out of accounts must be considered in the calculation of performance. Since the mathematical model used is based on time weighted actions the payment of fees can and does affect the performance. By having the ability to withdraw our fees allows us to maintain quality control over our performance calculations as well as stay in compliance with regulations. If we are required to wait for

16398 N.E. 85th Street, Suite 201 • Redmond, WA 98052 • (425) 861-0112 • (425) 285-3858 (fax)

e-mail: dennis@sweetwaterinv.com

the clients to pay us we will lose control of the performance calculation introducing errors. How can one determine the true cost of investment if the investment corpus does not bear the costs? How are we to maintain GIPS compliance?

2. Good business practice as well as common sense dictates that a business should expedite its collection of accounts receivable while extending its payables. In most cases advisors are only paid at the end of each quarter. In the case of many advisors cash flow at the end of quarters in critical if not negative. This rule would force advisors to stop billing client accounts and thereby avoiding the audit or continuing the practice, absorbing the audit. The decision will be made with perfect rationality- that is it will be made on the basis of what is the most profitable. Since the SEC registration is not a guarantee to a client of the honesty of the advisor, most advisors will find the imposition of audit a nuisance they can do without. The rule will therefore reduce the Commission control and therefore make the imposition of new and more burdensome rules necessary. This will create a downward spiral of the regulations and costs that will end badly.

This firm uses three primary custodians: Charles Schwab, TD Ameritrade, and JP Morgan each of which have different but equally restrictive rules regarding the movement of client assets. Regardless of what we might wish, the custodians act as a control on the movement of client assets. As an example, all of our custodians require that when we bill fees we certify that we are simultaneously transmitting a statement to the client as well as the custodian. Second, the compliance departments of all the custodians monitor the amount and frequency of fees charged in relation to assets to prevent excessive fees.

Under no common sense definition of custody does Sweetwater which only withdraws fee have the sort of unlimited control of client assets that would lead to the types of violations the Commission is seeking to prevent. Where there is a proper separation of the custodial function from the manager the problem you are seeking to solve does not exist. No manager using a non related third party custodian is going to be able to steal enough money to make it worth the while.

The same considerations exist with regard to other withdrawals of funds. All the custodians require that checks, money links, or wires be to an account in the client's name. If a client wishes to have money sent to a third party such as an escrow account, the custodians require a separate authorization from the client. This same restriction occurs in the case of a married couple who maintain separate brokerage accounts. If funds are to be sent from the account of the wife to a bank account in joint name the custodians require a separate authorization from both parties.

Can client assets be misdirected even when held by an independent custodian? Yes, but there is no system that can be guaranteed to prevent all fraud and embezzlement. The proposed surprise audit will do nothing to prevent a determined thief from acting. In fact, the imposition of a surprise audit and its attendant cost will have the opposite effect (see discussion below).

The answer to your question on page 10 and 11 regarding the ease of abuse is yes. Allowing advisors to only withdraw fees is less likely to be abusive than other forms of custody.

I believe one method to resolve the issue is to prohibit any advisors registered with he Commission or subject to FINRA from having assets at a related party custodian. This would apply to the large brokers owed by banks (Smith Barney) those advisors who are bank holding companies (Morgan Stanley, Goldman Sachs). If an independent custodian is in place then the issue of related party custody evident in the Madoff matter is resolved. The Commission can then focus its limited resources on fewer targets.

Possible Consequences of the Audit requirement

One of the underreported and I believe misunderstood aspects of the recent financial implosion has been the effect existing regulations have had driving many advisors to modalities where less transparency existed. In some advisors minds "transparency" equates to lower profits and less freedom since the method of achieving transparency has been a patchwork of regulations and procedures that were not monitored or enforced with vigor. At the same time the increased costs of regulation has made large size a virtue. The history has been than when large firms decide to move for liberalization of regulations to benefit their narrow interests, they get their way, i.e. the termination of the uptick rule in 2007 and the removal o f the net capital rule for the 5 largest investment banks in 2005 both of which were done largely *in camera* to the benefit of the largest firms. The failure of Lehman and Bear Stearns provides eloquent testimony to the wisdom of such decisions.

The imposition the surprise audit will increase the costs of operation which will lead a certain number of advisors, who otherwise would welcome the Commission's oversight, to find methods to avoid the expense that could include cessation of business, deregistering with the Commission, off shore locations and legal forms of organization outside the Commission's purview. This is similar to what Madoff and Sanford have done.

Second, the rule will be subverted by the larger firms as soon as they find compliance uncomfortable just as they did with the so called Merrill Lynch Rule. This would leave the Commission with actually less control and less valid information.

II. The Surprise Audit

It appears from the language on page 9 that the Commission's primary reason for this audit requirement is to create "another set of eyes" watching client assets. How many set of eyes to do you want? You already have the advisor and its compliance officers, the existing custodian and finally and seemingly forgotten the client and their advisors. Clients have a responsibility to themselves to be a set of eyes over their own money. In the military there was an old saying that you can delegate your authority but you can never delegate your responsibility. When the clients hire an advisor they are not immediately freed from any responsibility. Three sets of eye should be enough.

The second issue with the audit is that the expense to the advisor will be enormous. I am not sure where the Commission came up with its cost figures but they bear no relationship to the actual cost of audit prevailing in the Seattle community. I have personally polled four accounting firms (one national, one a prominent large regional with an extensive practice devoted to financial advisors, and two smaller regional firms) all are held in high regard, have experience with securities issues and audit ERISA plans.

The least price I was quoted for 6 audits per year was $12,000 and the highest $60,000. These costs are unsupportable by most firms. An audit cost of $60,000 will require all the fees generated by $8 million in client assets (assuming a.75% fee) just to pay for the audits. That would represent a significant diversion of fees and would therefore adversely affect the profitability of the firms.

Since either the Commission or the proposed auditing firms have developed a scope of work and judicial standards any forecast of the expenses will be prone to substantial errors. Auditing does not stop fraud, Madoff was audited, what he was missing was comprehensive regulation.

This loss of profitability will cause an unknown number of advisors to cease business termination and would accelerate the movement to larger firms. The departure of some advisors would act to reduce customer choice and create the same moral hazard the FDIC and the Federal Reserve found in allowing commercial banks to become " to large to fail".

III. Conflict of Interest

In the proposed rule there would be a requirement that each advisor subject to the audit would be required to provide clients name and contact information. This seems to violate the terms of the Graham, Leach, Biley Act with regard to disclosure of non public information. Such a requirement would cause a number of clients to seek alternative investment advisors not subject to the audit or to register their assets in vehicles that would not disclose their true identity. So the requirement would create a fugitive class of investors and advisors.

Many of the CPA firms who are likely to be engaged are going to have a conflict of interest since they may prepare the taxes for clients of the advisor or even the advisor itself. Also many CPA firms are also investment advisors affiliated with larger firms and insurance companies, providing client identity to such a firm would be commercial suicide. It would also be an actionable conflict of interest since it appears to conflict with the President's proposed fiduciary standard.

Finally, there is the question of who pays for this. There is an old German proverb "whose bread I eat, his song I sing." If the advisor is paying the accountant how is that any more of a safeguard than what we currently have? Enron paid Arthur Anderson's audit fees and that audit provided the public no safety.

An audit does not necessarily mean anyone is any safer. Bad actors exist along the spectrum and a determined thief will not be stopped by an audit.

Suggestions:

Unless an advisor has a pooled investment vehicle they should not be audited. Instead those firms with non pooled assets held at a independent custodian, should be required to submitted on ADV II an attachment of their compliance proceeds for prevention of misuse of client funds

Enact a rule that all firms and all vehicles must be held by a non related third party custodian. This will be in keeping with fiduciary standards and trust law.

If the Commission should decide to impose this rule and I hope they do not, the Commission should engage the auditing firms directly. This would mean that the Commission would be the client and the audit firm would be under the purview of the Commission. The Commission should pay the audit fee for those advisors with pooled investment vehicles with assets less than $50 million (including debt and margin loans). For advisors with more than $50 million there should be a sliding fee representing asset size and complexity.

All organizations who have any ability to taking client money from any US citizen (brokerage houses, banks, hedge funds, mutual funds, exchange traded funds and others) **other than fees** will be subject to the audit. If an advisor has the ability to pay the client's bills, or transfer money to non-related accounts they should be subject to audit.

Make a notice to all the investing public that they have responsibility to perform due diligence on their advisors and to reconcile their statements, have regular meetings with their advisors. They should also be notified that the Commission and courts will not hear cases from investors who do not perform basic due diligence on their advisors unless the client accepts the full cost of the prosecution. No more "I was stupid" cases or "I did not pay attention so therefore someone needs to make me whole".

The most effective thing the Commission can do to restore trust is to go to Congress and request an allocation of money to audit and inspect every registered investment manager in the nation within the next two years. It should also ask to increase the number of examiners by 100%. It should also impose a common standard on all advisors and that should be the fiduciary standard imposed by the 1940 Act. No more double or triple standards and rules. If the Commission adopts the fiduciary standard and explains it to clients they will soon understand they are better protected under that standard than under the illogical standards which allowed Madoff to become the reptile he was.

Thank you for your consideration of these remarks

Dennis R. Gibb
President