

regulation constitutes a “major” rule. Under SBREFA, a rule is considered “major” where, if adopted, it results in or is likely to result in: (1) an annual effect on the economy of \$100 million or more; (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effects on competition, investment or innovation.

We request comment on the potential impact of the proposed rule amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

IX. STATUTORY AUTHORITY

We are proposing amendments to rule 206(4)-2 (17 CFR 275.206(4)-2) pursuant to our authority set forth in sections 206(4) and 211(a) of the Advisers Act (15 U.S.C. 80b-6(4) and 80b-11(a)). We are proposing amendments to rule 204-2 pursuant to the authority set forth in sections 204 and 211 of the Advisers Act (15 U.S.C. 80b-4 and 80b-11). We are proposing amendments to Part 1 of Form ADV (17 CFR 279.1) pursuant to our authority set forth in sections 203(c)(1), 204, and 211(a) of the Advisers Act (15 U.S.C. 80b-3(c)(1), 80b-4 and 80b-11(a)). We are proposing amendment to Form ADV-E (17 CFR 279.8) pursuant to our authority set forth in sections 204, 206(4), and 211(a) of the Advisers Act (15 U.S.C. 80b-4, 80b-6(4), and 80b-11(a)).

LIST OF SUBJECTS IN 17 CFR PARTS 275 AND 279

Reporting and recordkeeping requirements, Securities.

TEXT OF PROPOSED RULE AND FORM AMENDMENTS

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 275.204-2 is amended by:

a. Removing “in effect, and” at the end of paragraph (a)(17)(1) and adding in its place “in effect;” ;

b. Removing the period at the end of paragraph (a)(17)(ii) and adding in its place a semicolon; and

c. Adding paragraph (a)(17)(iii).

The addition reads as follows:

§ 275.204-2 Books and records to be maintained by investment advisers.

(a) * * *

(17) * * *

(iii) A copy of any internal control report obtained or received pursuant to § 275. 206(4)-2(a)(6)(ii).

* * * * *

3. Section 275.206(4)-2 is revised to read as follows:

§ 275.206(4)-2 Custody of funds or securities of clients by investment advisers.

(a) Safekeeping required. If you are an investment adviser registered or required to be registered under section 203 of the Act (15 U.S.C. 80b-3), it is a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of

section 206(4) of the Act (15 U.S.C. 80b-6(4)) for you to have custody of client funds or securities unless:

(1) Qualified custodian. A qualified custodian maintains those funds and securities:

- (i) In a separate account for each client under that client's name; or
- (ii) In accounts that contain only your clients' funds and securities, under your name as agent or trustee for the clients.

(2) Notice to clients. If you open an account with a qualified custodian on your client's behalf, either under the client's name or under your name as agent, you notify the client in writing of the qualified custodian's name, address, and the manner in which the funds or securities are maintained, promptly when the account is opened and following any changes to this information. Include in the notification a statement urging the client to compare the account statements he or she shall receive from the custodian with those from the adviser.

(3) Account statements to clients. You have a reasonable basis, after due inquiry, for believing that the qualified custodian sends an account statement, at least quarterly, to each of your clients for which it maintains funds or securities, identifying the amount of funds and of each security in the account at the end of the period and setting forth all transactions in the account during that period.

(4) Independent verification. The client funds and securities for which you have custody are verified by actual examination at least once during each calendar year by an independent public accountant, pursuant to a written agreement between you and the accountant, at a time that is chosen by the accountant without prior notice or

announcement to you and that is irregular from year to year. The written agreement must also require the accountant to:

(i) File a certificate on Form ADV-E (17 CFR 279.8) with the Commission within 120 days of the time chosen by the accountant in paragraph (a)(4) of this section, stating that it has examined the funds and securities and describing the nature and extent of the examination;

(ii) Upon finding any material discrepancies during the course of the examination, notify the Commission within one business day of the finding, by means of a facsimile transmission or electronic mail, followed by first class mail, directed to the attention of the Director of the Office of Compliance Inspections and Examinations; and

(iii) Upon resignation or dismissal from, or other termination of, the engagement, or upon removing itself or being removed from consideration for being reappointed, file within four business days Form ADV-E accompanied by a statement that includes:

(A) The date of such resignation, dismissal, removal, or other termination, and the name, address, and contact information of the accountant; and

(B) An explanation of any problems relating to examination scope or procedure that contributed to such resignation, dismissal, removal, or other termination.

(5) Special rule for limited partnerships and limited liability companies. If you or a related person is a general partner of a limited partnership (or managing member of a limited liability company, or hold a comparable position for another type of pooled investment vehicle), the account statements required under paragraphs (a)(3) of this section must be sent to each limited partner (or member or other beneficial owner).

(6) Investment advisers acting as qualified custodians. If you or a related person maintains client funds or securities pursuant to this section as a qualified custodian in connection with advisory services you provide to clients:

(i) The independent public accountant you retain to perform the independent verification required by paragraph (a)(4) of this section must be a member registered with, and that is subject to regular inspection as of the commencement of the professional engagement period by, the Public Company Accounting Oversight Board in accordance with its rules; and

(ii) You must obtain, or receive from your related person, no less frequently than once each calendar year, a written internal control report prepared by an independent public accountant:

(A) The internal control report must include an opinion of an independent public accountant, issued in accordance with the standards of the Public Company Accounting Oversight Board, with respect to the description of controls placed in operation relating to custodial services, including the safeguarding of funds and securities held by either you or a related person on behalf of your advisory clients, and tests of operating effectiveness; and

(B) The independent public accountant must be a member registered with, and that is subject to regular inspection as of the commencement of the professional engagement period by, the Public Company Accounting Oversight Board in accordance with its rules.

(7) Independent representatives. A client may designate an independent representative to receive, on his behalf, notices and account statements as required under paragraphs (a)(2) and (a)(3) of this section.

(b) Exceptions. (1) Shares of mutual funds. With respect to shares of an open-end company as defined in section 5(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a-5(a)(1)) (“mutual fund”), you may use the mutual fund’s transfer agent in lieu of a qualified custodian for purposes of complying with paragraph (a) of this section.

(2) Certain privately offered securities. (i) You are not required to comply with paragraph (a)(1) of this section with respect to securities that are:

(A) Acquired from the issuer in a transaction or chain of transactions not involving any public offering;

(B) Uncertificated, and ownership thereof is recorded only on books of the issuer or its transfer agent in the name of the client; and

(C) Transferable only with prior consent of the issuer or holders of the outstanding securities of the issuer.

(ii) Notwithstanding paragraph (b)(2)(i) of this section, the provisions of this paragraph (b)(2) are available with respect to securities held for the account of a limited partnership (or limited liability company, or other type of pooled investment vehicle) only if the limited partnership is audited, and the audited financial statements are distributed, as described in paragraph (b)(3) of this section.

(3) Limited partnerships subject to annual audit. You are not required to comply with paragraph (a)(3) of this section with respect to the account of a limited partnership

(or limited liability company, or another type of pooled investment vehicle) that is subject to audit (as defined in section 2(d) of Article 1 of Regulation S-X (17 CFR 210.1-02(d)):

(i) At least annually and distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) within 120 days of the end of its fiscal year; and

(ii) Upon liquidation and distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) promptly after the completion of such audit.

(4) Registered investment companies. You are not required to comply with this section (17 CFR 275.206(4)-2) with respect to the account of an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 to 80a-64).

(c) Definitions. For the purposes of this section:

(1) Control means the power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract, or otherwise.

Control includes:

(i) Each of your firm's officers, partners, or directors exercising executive responsibility (or persons having similar status or functions) is presumed to control your firm;

(ii) A person is presumed to control a corporation if the person:

(A) Directly or indirectly has the right to vote 25 percent or more of a class of the corporation's voting securities; or

(B) Has the power to sell or direct the sale of 25 percent or more of a class of the corporation's voting securities;

(iii) A person is presumed to control a partnership if the person has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the partnership;

(iv) A person is presumed to control a limited liability company (“LLC”) if the person:

(A) Directly or indirectly has the right to vote 25 percent or more of a class of the interests of the LLC;

(B) Has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the LLC; or

(C) Is an elected manager of the LLC; or

(v) A person is presumed to control a trust if the person is a trustee or managing agent of the trust.

(2) Custody means holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them. You have custody if a related person holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services you provide to clients. Custody includes:

(i) Possession of client funds or securities, (but not of checks drawn by clients and made payable to third parties,) unless you receive them inadvertently and you return them to the sender promptly but in any case within three business days of receiving them;

(ii) Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian; and

(iii) Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives you or your supervised person legal ownership of or access to client funds or securities.

(3) Independent public accountant means a public accountant that meets the standards of independence described in rule 2-01(b) and (c) of Regulation S-X (17 CFR 210.2-01(b) and (c)).

(4) Independent representative means a person that:

(i) Acts as agent for an advisory client, including in the case of a pooled investment vehicle, for limited partners of a limited partnership (or members of a limited liability company, or other beneficial owners of another type of pooled investment vehicle) and by law or contract is obliged to act in the best interest of the advisory client or the limited partners (or members, or other beneficial owners);

(ii) Does not control, is not controlled by, and is not under common control with you; and

(iii) Does not have, and has not had within the past two years, a material business relationship with you.

(5) Qualified custodian means:

(i) A bank as defined in section 202(a)(2) of the Advisers Act (15 U.S.C. 80b-2(a)(2)) or a savings association as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)) that has deposits insured by the Federal Deposit Insurance Corporation under the Federal Deposit Insurance Act (12 U.S.C. 1811);

(ii) A broker-dealer registered under section 15(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)(1)), holding the client assets in customer accounts;

(iii) A futures commission merchant registered under section 4f(a) of the Commodity Exchange Act (7 U.S.C. 6f(a)), holding the client assets in customer accounts, but only with respect to clients' funds and security futures, or other securities incidental to transactions in contracts for the purchase or sale of a commodity for future delivery and options thereon; and

(iv) A foreign financial institution that customarily holds financial assets for its customers, provided that the foreign financial institution keeps the advisory clients' assets in customer accounts segregated from its proprietary assets.

(6) Related person means any person, directly or indirectly, controlling or controlled by you, and any person that is under common control with you.

PART 279 – FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

4. The authority citation for Part 279 continues to read as follows:

Authority: The Investment Advisers Act of 1940, 15 U.S.C. 80b-1, et seq.

5. Form ADV (referenced in § 279.1) is amended by:

a. In the General Instructions, revising the first bullet and last paragraph of instruction 4;

b. In Part 1A, revising the last paragraph of Item 7.A. and revising Item 9; and

c. In Schedule D, revising Sections 7.A., 9.C. and 9.D.

The revisions read as follows:

Note: The text of Form ADV does not and this amendment will not appear in the Code of Federal Regulations.

Form ADV

* * * * *

Form ADV: General Instructions

* * * * *

4. * * *

- information you provided in response to Items 1, 3, 9 (except 9.A.(2), 9.B.(2), and 9.(E)), or 11 of Part 1A or Items 1, 2.A. through 2.F., or 2.I. of Part 1B becomes inaccurate in any way;

* * * * *

If you are submitting an other-than-annual amendment, you are not required to update your responses to Items 2, 5, 6, 7, 9.A.(2), 9.B.(2), 9.E., or 12 of Part 1A or Items 2.H. or 2.J. of Part 1B even if your responses to those items have become inaccurate. If you are amending Part II, do not file the amendment with the SEC.

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Part 1A

* * * * *

Item 7 Financial Industry Affiliates

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A. * * *

If you checked Items 7.A.(1) or (3), you must list on Section 7.A. of Schedule D all your *related persons* that are investment advisers, broker-dealers, municipal securities dealers, or government securities broker or dealers.

* * * * *

Item 9 Custody

In this Item, we ask you whether you or a *related person* has *custody* of *client* assets and about your custodial practices.

A. (1) Do you have *custody* of any advisory *clients*':

	<u>Yes</u>	<u>No</u>
(a) cash or bank accounts?	<input type="checkbox"/>	<input type="checkbox"/>
(b) securities?	<input type="checkbox"/>	<input type="checkbox"/>

If you are registering or registered with the SEC, answer "No" to Item 9.A.(1)(a) and (b) if you deduct your advisory fees directly from your clients' accounts but you do not otherwise have custody of your clients' funds or securities.

(2) If you checked "yes" to Item 9.A.(1)(a) or (b), what is the amount of *client* funds and securities and total number of *clients* for which you have *custody*:

U.S. Dollar Amount	Total Number of <i>Clients</i>
(a) \$ _____	(b) _____

B. (1) Do any of your *related persons* have *custody* of any of your advisory *clients*':

	<u>Yes</u>	<u>No</u>
(a) cash or bank accounts?	<input type="checkbox"/>	<input type="checkbox"/>
(b) securities?	<input type="checkbox"/>	<input type="checkbox"/>

(2) If you checked "yes" to Item 9.B.(1)(a) or (b), what is the amount of *client* funds and securities and total number of *clients* for which your *related persons* have *custody*:

U.S. Dollar Amount	Total Number of <i>Clients</i>
(a) \$ _____	(b) _____

C. If you or your *related persons* have *custody* of *client* funds or securities, check all the following that apply:

- (1) A qualified custodian(s) sends account statements at least quarterly to the investors in the pooled investment vehicle(s) you manage.
- (2) An independent public accountant audits annually the pooled investment vehicle(s) that you manage and the audited financial statements are distributed to the investors in the pools.

- (3) An independent public accountant conducts an annual surprise examination of *client* funds and securities.
- (4) An independent public accountant prepares an internal control report with respect to custodial services when you or your *related persons* are qualified custodians for *client* funds and securities.

The instruction to Item 9.A.(1)(a) and (b) above regarding fee deductions does not apply to this Item 9.C.

If you checked Item 9.C.(2), C.(3) or C.(4), list in Section 9.C. of Schedule D the accountants that are engaged to perform the audit or examination or prepare an internal control report.

D. Do you or your related persons act as qualified custodians for your *clients* in connection with advisory services you provide to *clients*?

	<u>Yes</u>	<u>No</u>
(1) you act as a qualified custodian	<input type="checkbox"/>	<input type="checkbox"/>
(2) your related persons act as qualified custodians	<input type="checkbox"/>	<input type="checkbox"/>

If you responded “yes” to Item 9.D.(2), list in Section 9.D. of Schedule D all your related persons that act as qualified custodians for your clients in connection with advisory services you provide to clients (you do not have to list broker-dealers already identified as qualified custodians in Section 7.A. of Schedule D).

E. If you are filing your annual updating amendment and you were subject to a surprise examination by an independent public accountant during your last fiscal year, provide the date (MM/YYYY) the examination commenced: _____

* * * * *

Schedule D

* * * * *

SECTION 7.A. Affiliated Investment Advisers and Broker-Dealers

You must complete the following information for each *related person* investment adviser and broker-dealer. You must complete a separate Schedule D Page 3 for each listed *related person*.

Check only one box: Add Delete Amend

Legal Name of *Related Person*:

Primary Business Name of *Related Person*:

Related person is (check only one box): Investment Adviser Broker-Dealer Dual (Investment Adviser and Broker-Dealer)

If the *related person* is a broker-dealer, is it a qualified custodian for your *clients* in connection with advisory services you provide to *clients*? Yes No

Related Person Adviser's SEC File Number (if any) 801- _____

Related Person's CRD Number (if any): _____

* * * * *

SECTION 9.C. Independent Public Accountant

You must complete the following information for each independent public accountant engaged to perform a surprise examination, perform an audit of a pooled investment vehicle that you manage, or prepare an internal control report. You must complete a separate Schedule D Page 4 for each independent public accountant.

Check only one box: Add Delete Amend

(1) Name of the independent public accountant:

(2) The location of the independent public accountant's office responsible for the services provided:

(number and street)

(city) (state/country) (zip+4/postal code)

(3) Is the independent public accountant registered with the Public Company Accounting Oversight Board? Yes No

(4) If yes to (3) above, is the independent public accountant subject to regular inspection by the Public Company Accounting Oversight Board in accordance with its rules? Yes No

(5) The independent public accountant is engaged to:

- A. audit a pooled investment vehicle
- B. perform a surprise examination of *client* assets
- C. prepare an internal control report

(6) Does the report prepared by the independent public accountant that audited the pooled investment vehicle or that examined internal controls contain an unqualified opinion?

Yes No

SECTION 9.D. *Related Person* Qualified Custodian

You must complete the following information for each of your *related persons* that acts as a qualified custodian for your *clients* in connection with advisory services you provide to *clients* (you do not have to list broker-dealers already identified as qualified custodians in Section 7.A. of Schedule D). You must complete a separate Schedule D Page 5 for each listed *related person*.

Check only one box: Add Delete Amend

Legal Name of *Related Person*:

Primary Business Name of *Related Person*:

The location of the *related person's* office responsible for custody of your *clients'* assets:

_____ (number and street)

_____ (city) (state/country) (zip+4/postal code)

Related Person is (check only one box):

- U.S. Bank or Savings Association
- Futures Commission Merchant
- Foreign Financial Institution

* * * * *

6. Form ADV-E (referenced in § 279.8) is amended by revising the instructions to the Form.

The revisions read as follows:

Note: The text of Form ADV-E does not and this amendment will not appear in the Code of Federal Regulations.

Form ADV-E

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INSTRUCTIONS

This Form must be completed by investment advisers that have custody of client funds or securities and that are subject to an annual surprise examination. This Form may *not* be used to amend any information included in an investment adviser's registration statement (*e.g.*, business address).

Investment Adviser

1. All items must be completed by the investment adviser.
2. Give this Form to the independent public accountant that, in compliance with rule 206(4)-2 under the Investment Advisers Act of 1940 (the "Act") or applicable state law, examines client funds and securities in the custody of the investment adviser within 120 days of the time chosen by the accountant for the surprise examination and upon such accountant's resignation or dismissal from, or other termination of, the engagement, or if the accountant removes itself or is removed from consideration for being reappointed.

Accountant

3. The independent public accountant performing the surprise examination must submit (i) this Form and a certificate of accounting required by rule 206(4)-2 under the Act or applicable state law within 120 days of the time chosen by the accountant for the surprise examination, and (ii) this Form and a statement, within four business days of its resignation or dismissal from, or other termination of, the engagement, or removing itself or being removed from consideration for being reappointed, that includes (A) the date of such resignation, dismissal, removal, or other termination, and the name, address, and contact information of the accountant, and (B) an explanation of any problems relating to

examination scope or procedure that contributed to such resignation, dismissal, removal, or other termination:

(a) By mail, until the Investment Adviser Registration Depository (“IARD”) accepts electronic filing of the Form, to the Securities and Exchange Commission or appropriate state securities administrators. File the original and one copy with the Securities and Exchange Commission’s principal office in Washington, DC at the address on the top of this Form, one copy with the regional office for the region in which the investment adviser’s principal business operations are conducted, or one copy with the appropriate state administrator(s), if applicable; or

(b) By electronic filing of the certificate of accounting and statement regarding resignation, dismissal, other termination, or removal from consideration for reappointment on the IARD, when the IARD accepts electronic filing of the Form.

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By the Commission.

Elizabeth M. Murphy
Secretary

May 20, 2009