Timothy P. Turner [redacted]

July 27, 2009

BY ELECTRONIC FILING rule-comments@sec.gov

Elizabeth M. Murphy
Secretary Securities and Exchange Commission
100 F St NE
Washington DC 20549-1090

RE: File No. S7-09-09 (Custody of Funds or Securities of Clients by Investment Advisors)

Dear Ms. Murphy:

I appreciate the opportunity to comment on the U.S. Securities and Exchange Commission's (SEC) referenced proposal. My specific comments regarding the SEC's questions will be prefaced by some macro observations of the investment advisory/broker dealer business and a regulatory alternative.

I have had the pleasure of being in this business for going on over 20 years. Surprisingly, it has been almost evenly split between the business side as an advisory/broker dealer practitioner, supervising principal, and consultant; as well as a former regulator with NASD Regulation [nka Financial Industry Regulatory Authority (FINRA)].

While I applaud the SEC's effort to initiate and amend regulations to protect the interests of the investing public, I have also been a firm believer in trying to make sure the proposed (or existing) regulations are relevant to only those it should be relevant to. In footnote 11 of your proposing release, you sighted six specific instances of alleged fraudulent conduct, including misappropriation or other misuse of investor assets. [A lay person would just call it stealing] In four out of the six litigation's cited [excluding the Stanford (Rel No. 20901) and Madoff (Rel No. 20889)], the registered investment advisors allegedly used some sort of self-created investment fund or vehicle (e.g. Ltd Partnership, pooled Fund, LLC, etc) to solicit investor funds into…then the funds were allegedly used for other purposes besides what was marketed/touted to these investors. My experience with many investment advisors (including financial planners), is that they do not operate their advisory/planning practice by marketing/touting some sort of self-created investment entity, fund, and/or vehicle. Should we then look closer at the particular business aspects of the advisory firm as to whether there could be potential for misuse of investor assets requiring more specific internal controls and external regulatory requirements?

Proposed Alternative

If investment advisors (including financial planners) want to have custody/control of customer assets (funds and securities) as part of their business plan, then maybe the best regulatory framework is the existing regulations between "introducing" broker dealers and their clearing broker dealers/custodial banks that receive and have custody/control of funds and securities are subject to. Look at eliminating most of §275.206(4)-2 and subject advisors with custody the same as clearing broker dealers under the Exchange Act Rules (e.g. §240.15c3-1, §240.15c3-2, §240.15c3-3, §240.17a-5, §240.17a-13 to name a few); self-regulatory organizational rules related to clearing entities or banking laws governing custodial banks/trust companies.

There is currently no federally mandated financial or "capital" structure requirement for investment advisors except for some certain states that have a requirement. The same goes with an outside annual audit and fidelity/surety bonding. It's only been a few years since advisors have had to have some sort of written supervisory procedures.

This may sound radical, but if advisors feel compelled by their business plan to have custody/control of investor assets (customer funds & securities), beyond purely discretionary trading and fee debiting, then using the existing broker dealer or banking regulatory framework along with the SEC/Fed/OTS experience with oversight of this framework, may be more efficient in the long run versus amending/creating a different custody regime for advisors under 206(4)-2.

Unfortunately, no regulatory regime is perfect or will prevent 100% those determined to take advantage of investors, but by requiring some sort of mandatory "net-capital" structure; the establishment of a "reserve" to cover investor fund/security liabilities; and the mandatory regulatory reporting [e.g. the Financial and Operational Combined Uniform Single Reports (FOCUS reports)], this may give pause to advisors venturing off or expanding from the business of providing investment advice.

Comments regarding SEC Proposed rule.

A. Annual Surprise Examination of Client Assets

1. Application to All Advisors with Custody

Would an annual surprise examination increase protections afforded to advisory clients, including pooled investment vehicles (and the investors in those vehicles)?

To some degree, yes.

Should we except from the surprise examination requirement advisors that have custody of client funds or securities solely as a result of their authority to withdraw advisory fees from client accounts?

Solely having written discretionary trading and fee debiting would not be defined as having custody of client funds or securities based on my alternative proposal. The advisor and client would have to have a written agreement specifying this authorization and the ability for the client to unilaterally revoke it or have fees paid by manual invoice only. The custodian debiting the fee would notify the client separate from the advisor of the monies being withdrawn from their account. The custodian will electronically send fees only to a properly designated advisor bank account (with verifying paperwork). Annually, the advisor will provide each investor having fee's debited from their account, an annual "statement of fees" delivered to the investor so the investor could reconcile this statement with custodial records. Advisors would not be able to circumvent or have custodial statement go via them or an affiliate.

Is the form of custody, which is common to advisors with discretionary authority, less likely to be subject to abuse? Should we instead specify requirements or restrictions regarding withdrawing fees from client accounts? If so*, what should they be?*

Same comments as the first question.

Are there alternatives to the surprise examination that might provide similar protections, or are there additional requirements that we should consider? Should we instead (or also) amend rule 206(4)-7, which requires advisors to adopt compliance policies and procedures administered by a chief compliance officer, to require that the chief compliance officer submit a certification to us on a periodic basis that all client assets are properly protected and accounted for on behalf of clients?

See alternative proposed in my opening paragraphs above including having an advisory principal/officer similarly qualified as is a broker dealer's financial & operational principal (FINRA Series 27 or 28 exam qualified)

Should we specify certain minimum procedures that each chief compliance officer should implement to assure herself that all client assets are properly protected and accounted for…specify minimum requirements?

See proposed alternative above.

Should the rule require surprise examination to be conducted more frequently than annually or alternatively, on a regular periodic basis, e.g. semi-annually?

Under my proposed alternative, no. Otherwise, annually with SEC authority to impose more frequency if an annual exam detects material weaknesses/client exposure.

Should we continue to except advisors from the surprise examination requirement with respect to client assets held in pooled vehicles that are audited at least annually?

Since four out of the six cited SEC litigation cases involved some sort of advisor created investment vehicle (e.g. Ltd Partnership, LLC, pooled fund, etc), the audit of this type of advisor business activity needs to be better. If the outside annual audit procedures would uncover irregularities regarding assets/monies, then a surprise audit may serve no value. Adding a surprise audit, though, could be the deterrent from temptation.

Would the surprise examination's "verification" of client assets provide additional protection for clients of advisors that are also broker dealers?

Maybe. Three of the six cited SEC litigation cases mentioned may have affiliated broker dealer involvement where even that regulatory regime failed to uncover it. Further detailed information is needed before I could comment on that adding a surprise examination of the advisor would have detected the problems.

Do the custody obligations for banks present the same issues if an advisor is also a bank and maintains custody of client assets?

Yes, if the bank (or trust company) is affiliated or under control/influence of the advisory firm(s). The customer risk could potentially be the same as an affiliated/advisory controlled broker dealer.

Instead of requiring a surprise examination for advisors that also act as the qualified custodian for their clients' assets, should we instead consider a different approach, such as requiring these advisors to segregate custodial duties from advisory duties and implement additional internal controls to protect client assets?

See alternative already proposed.
Are there other procedures an accountant should perform as part of a surprise examination?

None come to mind other than a close audit trail of funds/securities activity.

Should we require an accountant to perform testing on the valuation securities, including privately offered securities, as part of a surprise examination?

No, not under this context.

Should we require an advisor to certify a listing of funds and securities and client accounts that are examined by the accountant as part of the surprise examination?

No, if under alternative proposed, as funds and securities should be readily identifiable via review of firm records versus depository (e.g. DTC, bank, 3rd party unrelated/independent custodian, etc) records. (See comments under private securities).

Are there any procedures currently required to be performed as part of a surprise examination that are no longer necessary?

No, not under proposed context.

Are there any procedures currently required to be performed as part of a surprise examination that should be clarified?

No, not under proposed context.

Have investment advisors' custodial practices or operations changed such that we should revise our existing guidance on performing the surprise examination?

No, not under proposed context.

Should we provide additional guidance to assist different types of advisors and their accountants in complying with the surprise examination requirements?

No, not under proposed context.

2. Commission Reporting

Should we require additional information be included in the accountant's certificate?

No.

Is the term "material discrepancy" widely understood by independent public accountants? Should we define the term or provide guidance as to the requirements?

To eliminate inconsistencies, the term should be defined as well as additional guidance provided.

Should we require the accountant's certificate to be provided to clients or investors in pooled investment vehicles?

No, but commentary regarding the examination results should be in annual audited report.

The 120 days reporting time is reasonable.

The reporting of a change is accountant firm is reasonable.

The accountant change/termination statement should not be automatically made publically available.

3. Private Offered Securities

Privately offered securities that are under the custody/control of the advisor should be covered by a surprise examination not different than publicly traded securities.

B. Custody by Advisor and its Related Persons

1. Custody by Related Persons

Should we deem an advisor to have custody if its related persons hold assets in connection with advisor's advisory services? Are there circumstances where a related person's custody of client assets should not be imputed to the advisor? If, so, should the rule contain a rebuttable presumption that an advisor has custody if any of its related persons have custody of advisory client assets? What factors, if any, should we identify for advisors to consider when assessing whether the presumption can be rebutted?

Yes, unless client assets (funds and securities) are held and accounted for by completely independent "qualified" custodian (e.g. a normal clearing broker dealer, custodial bank, etc)

A clear definition and guidance as to what defines a "related" entity or an entity that is "controlled" by the advisor/advisor management needs to be consistent.

2. Internal Control Report and PCAOB Registration and Inspection.

This requirement should be implemented for those advisory firms with custody which is fairly similar to some of the internal controls and procedures used by clearing broker dealers, etc. (See also alternative proposed)

The report requirement should be similar to current broker dealers under § 240.17a-5-Reports to be made by certain brokers and dealers.

3. Surprise Examination and PCAOB Registration

This requirement should be implemented.

4. Independent Qualified Custodian

Either the advisor has custody or its uses an independent (unaffiliated or controlled) qualified custodian for all customer funds and securities, period. This would include an advisory firm that is also a broker dealer/bank/trust company or related/affiliated/controlled by one. This should also include investment advisory firms whose owners/principals are registered representatives of a broker dealer (although the registered representative's advisory firm may not be defined as related/affiliated/common control as the broker dealer).

If a combination (related/affiliated/common control) advisory firm-broker dealer; or advisory firm-bank/trust company, etc had custody of client assets (funds or securities) by either of the entities, than it would be deemed to have custody fully subject to the same rules/procedures "clearing" broker dealers are subject to (see alternative proposed) or banks that perform similar services.

The only time this advisory "combination" or "group" of entities would not be deemed to have custody would be if **ALL** customer assets (funds and securities) were held and accounted for at an independent qualified custodian.

Many advisory firms currently hold client accounts at custodial broker dealers or custodial banks/trust companies, so there should little additional cost for investors. [These advisor "custodial" accounts look very similar to a fully-disclosed introduced customer accounts between a retail broker dealer and clearing broker dealer]

The only possible advisory firm exception to using a normal clearing broker dealer or bank would be financial planning firms whose clients may open direct held mutual fund accounts with the funds. The client opens the account but not through the advisor; and may or may not give the advisor 3rd party trading authorization. Fees are generally billed-invoiced directly to the client by the advisor and not by the advisor/mutual fund debiting the client accounts. This should be an allowable except as long as the advisor would not have any other incidence of custody/control (e.g. client bank accounts, trustee of trust accounts, General power of attorney over assets, etc).

C. Delivery of Account Statements and Notice to Clients

Should we eliminate the alternative delivery option in rule 206(4)-2?

Yes. Statements regarding assets (funds and securities) and activity should always go directly from the custodian to the client and not via the advisor. Advisor can receive a copy simultaneously (including on-line access). If the advisor wants to prepare other statements in conjunction to the custodial statements, fine.

D. Liquidation Audit

This amendment should be made.

E. Amendments to Form ADV

The amendments appear reasonable.

F. Amendments to Form ADV-E

The amendments appear reasonable.

G. Required Records

The required records, internal controls and procedures for advisors that have custody of client assets should be similar to those under the Exchange Act, self-regulatory organizations and banking laws that cover clearing/custodial entities.

The comments above reflect my personal thoughts and opinions only. They do not represent the thoughts or opinions of any investment advisory firm or broker dealer I may be associated with, or its management.

Sincerely,

Timothy P. Turner