July 28, 2009

Regarding: *File Number S7-09-09*

To whom it may concern:

I am emailing regarding the SEC's proposed changes to the custody rule, *Release No. IA-2876*.

Colman Knight Advisory Group LLC is an SEC Registered Investment Advisor and all the financial planners in the firm are members of the Financial Planning Association *(FPA)*, and half are Certified Financial Planner™ registrants. We object to the proposed rule that specifically, requires advisory firms that technically have custody of client assets -- solely because they are authorized by their clients to automatically deduct client fees from investment accounts -- to subject themselves to surprise audits is a hastily proposed solution for the wrong problem. A small minority of our clients prefer us to automatically deduct fees from their accounts to pay for our services. Most of the clients who request the accommodation are elderly and view the automatic deduction as something that makes their lives easier. Should the proposed rule be adopted by the SEC our firm will cease the practice of automatically deducting fees as a courtesy. The clients who request and need it will be burdened but the burden to my firm greatly outweighs theirs. So, we will no longer provide a service so that we can fall outside of the custody definition should that proposed rule be adopted by the SEC.

I want to formally object to part of the proposed amendments to the custody rule. Specifically, requiring advisory firms that technically have custody of client assets -- solely because they are authorized by their clients to automatically deduct client fees from investment accounts -- to subject themselves to surprise audits is a hastily proposed solution for the wrong problem. It is my understanding that the rule is an attempt to deal with the problems highlighted by the Madoff scandal. Madoff created fictitious statements and transactions never was he accused of inappropriate withdrawals from client accounts. Furthermore, unlike the creation of fictitious statements and transactions, to my knowledge there have never been any RIA issues concerning inappropriate fee withdrawals from client accounts.

Another major issue with this regulation is that surprise audits are very expensive; my understanding is that the SEC estimates the cost of the audit firm alone to be from $8,000 to $20,000 per audit. Given the fact that the vast majority of the 11,000 SEC registered firms are small, the proposal is coming during a time where SEC registered firms are facing some of their greatest challenges for survival, this regulation is certain to force many of the smaller firms to close. The closer of those smaller firms will hurt the economy and leave

much of the public without any advisor to assist them just when they need the help most

The surprise audit proposal appears to be a political reaction to the very public criticism of the SEC in the wake of the Madoff scandal. While I can certainly understand and support the need for more effective regulation, imposing a surprise audit requirement on advisors with no custody other than fee deduction rights, especially when non-affiliated 3rd-party custodians are being used, seems to be the wrong regulation to fix the perceived problem. A more appropriate response is to properly enforce current rules and regulations which were not followed during the multiple audits that Madoff encountered. During the company's entire multi decade existence it never once performed a trade on any exchange. It is my understanding that there were at least 8 occasions when that issue should have been uncovered, yet not once was the trading activities of Madoff reviewed to determine what the actual trades were, had that been done once, the scheme would have been uncovered.

It is my belief that proper enforcement of current rules by the SEC and FINRA would have included verifying actual trades and matching statements received by clients with those issued by Madoff. Had the SEC and FINRA performed that test, the Madoff scandal and other Ponzi schemes could have been prevented. Because of this simple fact, new proposed regulations need to be carefully scrutinized to prevent an overreaction to problems that should have been corrected by more effective enforcement of current rules. FINRA (and its predecessor NASD) was the regulatory body in charge of reviewing Madoff's decades-old broker-dealer business. It is amazing that more is not being done to hold FINRA responsible for not catching Madoff's long-running fraud before it grew to a multi-billion dollar problem. Certainly the SEC should have initiated more stringent action, but Madoff was only registered with the SEC as an investment adviser for the past few years. This is another reason to carefully scrutinize new proposed SEC regulations. And in fact, the SEC has already resolved one of the major problems with the custody rule by eliminating a loophole from registration for certain accounting firms with the PCAOB that Madoff's accountant used to avoid detection of its phony auditing practices.

The Madoff scandal points out the need for thorough audit examination of entities that do not use 3rd party custodians such as Madoff's firm. I agree with many of the other firms who have weighed in on this issue that the most appropriate regulatory response to the Madoff scandal would be for Congress to appropriate additional resources to the SEC to hire additional examination staff. This staff should then focus more of its resources on firms that have ***actual custody*** of their client assets and ***do not use 3rd-party custodians***. An established third party custodian does not allow withdrawals (other then fees) and delivers separate statements that give the client an automatic verification of their account balances and activities **– this arrangement provides built in protection for consumers**. Madoff could not have accomplished his fraud without sole custody

of “his clients’ funds. Therefore, when that situation exists, more stringent controls are needed.

Such stringent methods are not appropriate for advisors whose sole "custodial" position is client authorization to automatically deduct fees should be exempted from the surprise audit proposal, much in the same way that they were previously exempted from the former balance sheet requirement. So long as advisors use 3rd-party custodians who provide clients with periodic statements, there would be no decrease in consumer protection from this exemption. And advisors, which are mostly small businesses, would not be burdened with the tremendous additional cost of this proposed surprise audit requirement. This should help keep smaller advisors in business serving their clients, and allow all advisors to be able to afford to continue hiring new employees and growing their businesses, instead of having to cut back to afford this proposed new regulatory burden.

Thank you for your consideration – and for your support going forward. If you would like more input, please feel free to contact me.

Richard K. Colman, Esquire
Principal and Co-Founder