Advisor Solutions Group, Inc.
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July 28, 2009

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

RE: File Number S7-09-09;
Custody of Funds or Securities of Clients by Investment Advisers.

Dear Ms. Murphy:

We appreciate the opportunity to comment on the above referenced proposal. Advisor Solutions Group, Inc. is a compliance consulting firm that assists small to mid-sized investment advisers with registration and ongoing compliance needs. Our investment adviser clients typically have twenty or fewer employees and many have less than five. Their assets under management are each under one billion dollars and many manage less than three hundred million.

Most of our clients are independent registered investment advisers that have their clients utilize independent qualified custodians to custody their assets. Our advisory clients, even if they are dually registered as broker-dealers and investment advisers or if they have an affiliated broker-dealer, typically do not utilize their affiliated broker-dealer to custody advisory client assets, but instead use an independent broker-dealer. Additionally, our clients who are advisers and general partners to limited partnerships also utilize independent custodians for the custody of pooled investment assets.

Our comments stem from our individual and firm experience in consulting with investment advisers on custody matters and the custody rules as applicable to investment advisers (since before and after the amended custody rule in 2003). While many of our clients have expressed their concerns over the proposed rule to us, our views expressed in this letter are the views of this firm and not necessarily those of our clients.

We support the Commission's efforts to identify means to prevent the Madoff and similar types of fraud from being perpetrated against investors in the future. However, we believe many of the most costly provisions of the proposed rule will do little or nothing to prevent this type of fraud. Our comments are focused on the areas of greatest concern expressed to us by our clients with respect to the proposal: (1)

to require that *all* registered investment advisers with custody of client assets, in particular including those advisers who have custody solely for the purpose of debiting management fees, engage an independent public accountant to conduct an annual surprise examination of client assets; (2) to require an annual surprise examination of client assets, in the case of a pooled investment vehicle, even if the pool is audited at least annually and distributes its audited financial statements to its limited partners (or other investors) within 120 days of the end of its fiscal year; (3) to require all advisers that have custody, including advisers who have custody solely for the purpose of debiting management fees, to deliver account statements and include the proposed legend.

To item (1), we believe this proposal appears to be an over-reaction to public criticism of the Commission's failure to identify investment frauds that have been both spectacular in size and number. However, this part of the proposed rule is utterly incongruous with the potential fraud it would hope to prevent. Our reasons for this opinion are as follows:

(a) We believe the ability of advisers to debit management fees from client accounts is unlikely to be subject to abuse. This type of fraud would be limited in size and would inevitably lead to detection by either the clients or the custodian.

(b) The misappropriation cases cited in Footnote 11 of the release show no examples of advisers committing fraud via debiting management fees and none of the examples of fraud or alleged fraud include cases where client assets where held by an independent qualified custodian and the client received account statements directly from the qualified custodian. The proposal is a solution where there is no systemic problem.

(c) We are aware of one recent case filed by the SEC against an adviser in which the adviser fraudulently debited management fees from client accounts.[1] However, even this case is evidence that this type of fraud is very likely to be identified very quickly by clients or the independent custodian and will be very limited in scope. The lack of these types of cases and the limited scope of this type of fraud suggest to us that the proposed solution with a multi-million dollar annual price tag to prevent a few hundred thousand dollars worth of fraud is completely disproportionate. We do not mean to suggest that even a penny of loss to an investor due to fraud is acceptable, just that the proposed solution is not warranted and punishes the vast majority of honest advisers and their clients.

(d) Those persons intent on committing fraud will simply circumvent any regulation that is passed. Madoff's firm did not register as an investment adviser until 2006; therefore, the firm was not subject to the custody rule (although, perhaps it should have been) while Mr. Madoff perpetrated his fraud. Surprise audits of advisers who debit fees from accounts held with qualified custodians will not prevent the type of frauds recently seen and the costs far outweigh the potential benefits.

We support changing the definition of custody to exclude the ability to debit management fees from client accounts. This definition has been an area of great confusion since the adoption of the Custody Rule in 2003. As consultants, even six years later, we are still repeatedly explaining to established

[1] SEC v. Ryan M. Jindra and Envision Investment Advisors, LLC, et. al. (Case No. 8:09-cv-00216) filed June 30, 2009.

advisers that they have custody when their only access to client assets is by debiting management fees. This definition goes against all conventional understanding of the word, which to advisers and investors alike implies physical custody. Furthermore, it is additionally confusing that advisers with this type of custody can answer that they do not have custody on Form ADV.

We do not support the suggestion to amend Rule 206(4)-7 to require the CCO to submit a certification to the Commission on a periodic basis that all client assets are properly protected and account for. We also do not support defining minimum procedures that each CCO should implement. Rule 206(4)-7 is already sufficient to require advisers to adopt policies and procedures that are reasonably designed to protect investor assets and to annually test the effectiveness of those policies. The existing rule need only be enforced.

We request clarification on the applicability of the proposed new questions to Item 9 of Form ADV, Part 1A. Currently, the instructions to Item 9 of Part 1A permit advisers who have custody solely for the purpose of debiting management fees to answer “no” to Item 9A. If the surprise examination requirement of the proposed rule should be adopted, which we do not support, the Commission should clarify if those advisers, even if they may continue to answer “no” to Item 9A, would be required to report the amount of assets over which the adviser has custody, whether the adviser’s clients’ fund or securities are subject to a surprise examination, and report the month in which the last examination commenced. If advisers continue to be permitted to answer “no” to Item 9A, then requiring them to provide the additional information would only confound the confusion over the current definition of custody.

To item (2), similar to our comments to item (1), we believe this proposal is unnecessary. The financials of pooled investment vehicles in the majority of cases are already being audited by an independent public accountant in preparation of the annual audit reports that are sent to the investors. In many cases a separate independent accounting firm provides the service of daily fund accounting. Therefore, a third pair of independent accounting eyes would be overkill.

To item (3), we do not support the suggestion to require advisers who have custody solely for the purpose of debiting management fees to deliver their own account statements with the proposed legend to clients. The clients already receive statements directly from the independent custodian. To require advisers to send their own statements in addition would be to add an enormous cost and burden on those advisers that don’t currently send their own account statements with no known benefit.

Cost-Benefit Analysis

Our discussions of the cost-benefit analysis are limited to the portions of the proposed rule we commented on above.

(a) A cost-benefit analysis should compare the cost of compliance to the benefit the proposal is designed to achieve, i.e. the amount of loss prevented by the misappropriation of client funds.

Each cost for each recommendation under the proposal should be measured against the corresponding benefit. This proposal provides no such analysis and the proposed costs (greater than $89 million per year)[2] to require annual surprise examinations primarily of advisers who have custody solely for the purpose of debiting management fees is completely disproportionate to the potential savings. Furthermore, the Commission states in the release that the surprise examination by an independent public accountant "may indentify mishandling of client assets, which may result in the earlier detection of fraudulent activities and reduce resulting client losses."[3] The Commission provides nothing to support this conjecture.

(b) This proposal and cost analysis are being evaluated in a vacuum. However, the financial crisis has brought about an environment where Congress and the Commission are considering other changes to investment adviser regulation that potentially will be very costly to investment advisers (e.g. changes to Form ADV already proposed, mandatory independent annual reviews, an SRO for advisers, etc.). Also, this proposal comes only a few years after another very costly rule was passed, Rule 206(4)-7. While the cost of one proposal may be able to be absorbed, collectively, these proposals will drive some advisers, particularly smaller advisers, out of business, thus limiting competition and favoring larger firms.

(c) During the open meeting in which this proposal was approved for release, one of the Commission staff suggested that advisers could simply go back to manual billing in response to the rule. If advisers felt financially compelled to switch to manual billing, the cost to the adviser, the investment community, and their clients would be high. The advisers would incur additional labor, materials, and postage costs in sending invoices, processing checks, and following up on late or missed payments and returned checks (not to mention the environmental costs this would have). Advisers and their clients would also suffer an opportunity cost as advisers would be spending more time on billing and less time on compliance, research, portfolio management, and client service.

(d) Anytime the compliance costs of an adviser increase, if they are not absorbed by the Adviser, they are passed on to the client in higher fees, consequently resulting in lower returns after fees for investors. In this case, we believe the Commission would be creating a great expense for all advisers and investors with very little added protection for investors and prevention of fraud.

(e) The release states that the Commission believes that advisers only have authority to debit management fees from discretionary accounts.[4] We believe this is an inaccurate assumption and therefore any cost estimates based on this assumption are understated. We advise some clients who actively manage client accounts on a non-discretionary basis and also have the authority to debit the management fees from the client accounts.

(f) The Commission estimates that advisers would be required to obtain annual surprise examinations with respect to 8,214,462 clients' accounts.[5] However, that number was arrived by

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[2] From the proposing release: Collection burden for the annual surprise examinations of $11,783,898 per year and accounting fees for annual surprise examinations of $77,557,500.

[3] Proposed Rule: Custody of Funds or Securities of Clients by Investment Advisers, [Release No. IA-2876; File No. S7-09-09], page 56.

[4] *See supra* note 3, Footnote 79.

[5] *See supra* note 3, Footnote 135.

totaling the Commission's estimates of the number of clients of these advisers (not of accounts). In fact, many clients have multiple accounts (e.g. husband and wife IRAs, one or more family trusts, etc.) If the average number of accounts per client was 2, that would double the estimates of the number of accounts to be examined. Would this also double the cost estimate?

(g) We were of the impression based on comments made during the open meeting that the Commission's estimate that on average the annual audit would cost $8,100 per adviser may have been based on research conducted in 2002. Has this number been adjusted for inflation? Any consideration of this proposal should be based on current and accurate estimates of the costs to both small and large advisers.

Consideration of Impact on the Economy

We believe the proposed rule constitutes a "major" rule, as the estimated costs of the rule exceed $100 million per year. We believe the proposed rule could lead to major increases in costs for investors as advisers pass on the additional compliance expense in the form of higher fees to investors. We believe the proposed rule will have a significant adverse impact on competition. This rule will be a particular burden on smaller investment advisers potentially leading smaller advisers to either leave the business or merge with larger advisers. This will have the effect of reducing competition for investors. Small businesses create most of the nation's new jobs and employ about half of the nation's private sector work force.[6]

Alternatives

We believe and support the following suggestions as a better solution to preventing the Madoff-type of frauds in future years. The Commission should:

(a) beef up and increase the regular audit cycle of investment advisers;
(b) focus more resources and hire and train additional staff to detect fraud and investigate whistle blower tips and referrals;
(c) step up enforcement; and
(d) enhance investor education.

We appreciate the opportunity to comment on this proposal. If you have any questions or would like to request clarification, please contact me at 949.250.1855, via e-mail, or the address above.

Sincerely,

Krista S. Zipfel, CFA
President & CEO

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[6] 2009 The Small Business Economy: A Report to the President, The Small Business Administration, United States Government Printing Office; Washington: 2009