July 28, 2009

The United States Securities
and Exchange Commission
rule-comments@sec.gov

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

Ladies and Gentlemen:

I am writing on behalf of Victory Capital Management Inc. (Victory), a registered investment adviser, and wholly owned subsidiary of KeyBank National Association. We would like to thank the Commission for the opportunity to comment on the proposed revisions to Rule 206(4)-2 of the Investment Adviser's Act of 1940, as amended (the "Advisers Act"). The Securities and Exchange Commission (SEC) should be commended for its ongoing efforts to protect client assets. In light of recent abuses by a small number of unscrupulous advisers, reviewing the custody rule makes good sense. We would like to submit, for your consideration, the following concerns and comments relative to the proposed rule.

Defining Custody

a) Ability to Take Fees From a Client's Custodial Account

Currently, and as proposed, investment advisers who have the ability to take their fees from assets in their client's custodial accounts are considered to have custody of those assets. Rule 206(4)-2(c) (1) (ii). We believe that attribution of custody based solely on the ability of an investment adviser to take its fee directly from a client's custodial account should be excluded from the attribution of custody under the Rule. The likelihood for abuse as a result of this practice is minimal. This is even more so where the investment adviser submits its fee statement to the client. The client can then review the fee being charged. Under some arrangements, the client may pay the fee directly or instruct the custodian to pay the fee from the assets under the custodian's control. Alternatively, the client could provide an ongoing instruction to the custodian to pay the fee from the custodial account upon the custodian's receipt of a duplicate fee statement. In each instance, the client would receive the fee statement and be afforded the opportunity to review the statement for accuracy.

b) Related Person Custody

Proposed Rule 206(4)-2(c) attributes custody to an investment adviser if a related person holds, or has authority to possess, client funds or securities in connection with the advisory services being provided. We urge the Commission to specifically exclude from this custody attribution those related persons who are banks, as defined in Section 202(a)(2) of the Advisers Act, that act as Qualified Custodians under Rule 206(4)-2.

Where a highly regulated entity, subject to stringent regulatory inspection and oversight, is related to the investment adviser, the possibility of improper activity between the entities, or by any one of them, is very small.

Where the related person is a national bank, the Office of the Comptroller of the Currency (OCC) has established specific examination and oversight protocols. Each national bank has an examiner assigned to it, and at a large national bank the OCC maintains a continuous program of risk assessment. Examiners are assigned to, among other things, supervise the quality and effectiveness of the bank's procedures utilizing periodic testing. Examiners operate full time, and on site, regularly communicating findings and requirements to bank management, and obtaining commitments to corrective actions as necessary. The examiners then verify the effectiveness of the corrective action and may, if necessary, pursue further action to obtain and enforce compliance. The *Comptroller's Handbook for Custody Services* specifically discusses the requirements for safekeeping of custody assets; settlement of securities transactions, recordkeeping and reporting, and securities servicing, all within the context of risk management by the custodial bank.

Additionally, all national banks are required to have annual examinations performed by the OCC. Annual audits of financial statements must be performed by independent auditors. Each insured depository institution must appoint an audit committee of its Board of Directors and provide an annual report, with management's statement of responsibility, to the FDIC, the applicable federal banking agency and, if applicable, a state bank supervisor. A separate internal control report, attested to by an independent public accounting firm, must also be prepared and submitted.

Banks that have traditional trust and custody businesses have long been required, out of business necessity, to have sophisticated accounting systems on which account assets are stored and reported. The balances and control components of those systems are required to have such things as dual controls to prevent fraudulent activity and are subject to compliance and audit testing and exams (by both internal and external auditors). We believe that these provide adequate safe guards.

In addition, banks providing custodial services must meet guidelines established by the American Institute of Certified Public Accountants ("AICPA") for bank trust departments when producing information for custodial accounts on which accountants for qualified retirement plans can rely. Statement on Auditing Standards No. 70: Service Organizations, commonly abbreviated as SAS 70, is an auditing statement issued by the Auditing Standards Board of the AICPA, officially titled "Reports on the Processing of Transactions by Service Organizations". SAS 70 defines the professional standards used by a service auditor to assess the internal controls of a service organization and issue a service auditor's report. This report includes the service auditor's opinion on the fairness of the presentation of the service organization's description of controls that had been placed in operation and the suitability of the design of the controls to achieve the specified control objectives. A Type II SAS-70 Report will also include the service auditor's opinion on whether the specific controls were operating effectively during the period under review. Custodial bank's which produce a Type II SAS-70 Report therefore undergo a significant screening with respect to custodial activities.

This stringent regimen of supervision by government, industry groups and professional organizations, helps to insure that the assets being held in custody at the bank are safe, and safe from actual, or perceived, conflicts of interest between a registered investment adviser and its related bank custodian. Consequently, we suggest that the Rule reflect that banks, as defined in Section 202(a) (2) of the Adviser's Act, that are related persons to the investment adviser and act as qualified custodians for client accounts, be excluded from the definition of "custody" that is attributed to a registered investment adviser.

Use of Independent Qualified Custodians

Victory agrees that requiring the use of independent qualified custodians for investor's accounts would help eliminate the potential for conflict of interest. However, and as noted above, where a related Qualified Custodian is a highly regulated entity subject to stringent inspection and oversight, such as a bank as defined in Section 202(a)(2) of the Advisers Act, the regulatory controls and supervision in place are sufficient safeguards against such conflicts.

Additionally, any prohibition of a bank affiliated registered investment adviser to make its services available to the bank's customers, where the bank has custody of its customer's assets, will have a detrimental effect on the investment adviser, on the bank, and on the bank's customers. Bank customers will be forced to move their management accounts to new investment advisers. Bank Trustees' obligations may be compromised by their inability to consider beneficial services that could be provided by an affiliated adviser. Advisers will lose assets under management. Customer cost and inconvenience may increase.

Based on the foregoing, it would not be in the best interest of any party to require the use of independent custodians if that included banks, acting as qualified custodians under the Adviser's Act, who are related persons to an investment adviser.

Surprise Examinations

Properly focused annual surprise examinations could provide additional oversight to protect against abuses. However, where the custodian is already subject to significant regulatory oversight and supervision, the proposed annual surprise examination would be excessive and largely duplicative. Additionally, it has been our experience that the cost of similar examinations has far exceeded the cost estimates mentioned in the Commission's discussion. The cost would likely be passed through to clients in the form of increased fees. For many small investment advisers, this added cost could be prohibitive and severely impact the adviser's business. It would be helpful to an analysis of this issue if more specific information, relative to scope and cost, were available from those accounting firms who would qualify to perform the examination.

Thank you for your consideration of the above comments.

Very truly yours,

Richard G. Zeiger
Secretary and Counsel