CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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July 28, 2009

Elizabeth M. Murphy
Secretary
U.S. 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:

The U.S. Chamber of Commerce (the "Chamber") is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. The Chamber's Center for Capital Markets Competitiveness (CCMC) works to ensure that our nation's capital markets are the most fair, efficient, and innovative in the world. The Chamber supports the efforts of the U.S. Securities and Exchange Commission ("SEC" or "Commission") to restore and maintain investor confidence in our marketplace.

The aim of the proposed amendments to Rule 206(4)-2 of the Investment Advisers Act of 1940 ("Proposal") is to provide additional safeguards to client funds under custody of the adviser. The CCMC is concerned, however, that the Proposal would have negative and unintended consequences for advisers, their clients, and the audit industry, far beyond the client benefits articulated in the proposing release. We urge the SEC to reevaluate the cost-benefit analysis of the proposed amendments and consider alternative safeguards for client assets that do not impose such unnecessary costs to the advisory industry. The SEC should focus on increasing the effectiveness of the current safeguards and oversight tools, rather than adding additional and overlapping layers of audits to the current requirements.

The current rule now requires advisers to maintain custody of client funds and securities with a qualified custodian, typically a third-party broker-dealer or bank. Another key function of the current rule is to provide investors with adequate transparency, through detailed quarterly or annual statements, related to their invested capital and the investing activities of their advisers. In response to recent scandals, the Commission has proposed amendments to Rule 206(4)-2 that would require, among other things, advisers to engage an independent audit firm to conduct an annual surprise examination and, in certain circumstances, to produce an internal control opinion.

As described below, the Chamber is concerned that the Proposal would impose significant additional costs on registered advisers without providing a proportionate benefit to clients. These changes would do little to address the risk of misappropriation sought to be resolved by the Proposal. The substantial increase in compliance costs would inevitably be passed down to investors. Furthermore, the Proposal includes distinctions between audit firms registered and inspected by the Public Company Accounting Oversight Board ("PCAOB") and those that are not. These nuances will not be well understood by investors and will likely present some advisers and auditors with transition issues.

I. The Proposed Amendments would Impose Substantial Costs on Investment Advisers without Providing a Proportionate Benefit for Investors

There are over 11,000 investment advisers currently registered with the SEC ranging from small local and regional advisers to large institutional firms. Advisers vary widely in size and structure to meet the diverse needs of U.S. investors – from retail investors on Main Street to institutional investors on Wall Street. Under the current rule, advisers rely on qualified custodians to provide custody of client assets and, in many cases, deliver account statements directly to their clients. The current framework provides clients with the confidence that unauthorized or erroneous transactions will be reflected in their quarterly statements and provides regulators with the tools to detect and deter fraudulent practices. Qualified custodians, typically broker-dealers or banks, are already subject to comprehensive regulatory oversight.

Current rules also require advisers to private pools of capital, which obtain self custody of part or all of client assets, to send independently audited financial statements to their clients annually to serve the goal of transparency.

A. Annual Surprise Audit

The proposed amendments seek to strengthen investor confidence by requiring an annual surprise audit, focused on the verification of client assets, by an independent public accountant for all investment advisers deemed to have "custody" of client assets. In addition, for investment advisors acting as qualified custodians, the independent public accountant conducting the surprise examination must be registered with, and regularly inspected by, the PCAOB.

As the many comment letters on the Proposal emphasize, this new requirement would impose a substantial amount of additional costs on advisers of all sizes without providing clients any proportionate benefits. The cost to engage independent accountants to verify 100% of client securities positions far exceeds the risk of fraud or misappropriation sought to be addressed. Imposing this requirement on advisers that are deemed to have custody solely because they have the authority to deduct fees from client accounts is unnecessary given the current safeguards: adviser's fees are negotiated with the clients, clients agree to have fees deducted from their accounts, and clients receive quarterly account statements directly from their custodian.

The requirements would also extend to advisers of private investment pools that already have robust rules in place to protect client assets. The investment pool is audited annually by an independent audit firm and the audited financial statements are delivered to investors within 120 days of the end of the fiscal year. Through this process, an appropriate sample of client assets is verified and controls are reviewed and evaluated to prevent fraud. An additional surprise audit would not add significant safeguards to those provided through annual audits, yet would impose substantial and unnecessary costs on advisers to private pools of capital. Regulators should make adjustments to their examination and oversight procedures rather than shifting this responsibility, and the accompanied costs, to the advisory industry.

B. Internal Control Reports for Advisers that Self Custody Client Assets

For investment advisers acting as qualified custodians of client assets, including advisers to private investment pools that maintain self custody of client assets, the proposed amendments would require an additional annual internal control report, known as a Type II SAS 70 report, to be provided by an audit firm that is both registered with, and regularly inspected by, the PCAOB. The costs of obtaining a control report when an adviser maintains self custody of only a small percentage of client assets will far outweigh benefits to investors. As noted above, advisers to private pools of capital already have their financial statements audited once a year by an independent public accountant. The minor protections that could be gained from requiring an additional internal control report do not satisfy an appropriate cost-benefit analysis when considering the significant additional costs that would be incurred to obtain such a report.

II. Use of PCAOB Registered and Regularly Inspected Independent Public Accountants

As noted, the proposed amendments introduce a bifurcated scheme whereby some surprise examinations and all internal control reporting would need to be conducted by independent public accountants registered with, and subject to regular inspection by, the PCAOB. In accordance with the Sarbanes-Oxley Act of 2002 ("SOX") and the implementation rules of the SEC and PCAOB, only public accounting firms that audit *issuers* are *both* registered with the PCAOB and subject to regular inspections.[1] In addition, for PCAOB registered and inspected audit firms, only issuer engagements are subject to PCAOB inspection. Thus, even for PCAOB registered and inspected audit firms, surprise exams and internal control reporting

[1] Recently, the SEC required that the annual audits of registered broker-dealer financial statements be performed by public accounting firms *registered* with the PCAOB. However, SOX does *not* give the PCAOB authority to *inspect* registered auditors of broker-dealers unless they likewise audit issuers and, even then, non-issuer broker-dealer audit engagements are not subject to PCAOB inspection. Legislation (H.R. 1212) has been introduced to change this situation. H.R. 1212 would give the PCAOB inspection authority over registered non-issuer broker-dealer auditors and engagements. But this legislation remains pending. And, as drafted, the legislation does not extend PCAOB inspection authority to audits of non-issuer investment advisers.

would not be subject to PCAOB inspection. Not only are these nuances likely to confuse investors, but they make investor protection arguments problematic in regards to this proposal.

The current state of affairs also means that some advisers and auditors will face transition issues. For example, using the SEC's own estimate of over 370 advisers becoming subject to internal control reports, it appears likely that at least some advisers would not have auditors that meet the proposed threshold requirement of PCAOB registration and regular inspection. Thus, advisers not currently using a PCAOB registered and inspected auditor will incur additional transition costs.

Furthermore, the bifurcated scheme set forth in the Proposal would institute a higher threshold for public accounting firms to perform some surprise examinations and provide all internal control reports than the threshold in any existing requirements to perform annual financial statement audits of registered advisers. The Proposal does not discuss a rationale for doing so and we can think of none. Finally, this discussion demonstrates the importance of the Commission resolving the PCAOB's jurisdiction, particularly its inspection authority, over audit firms engaged by advisers before proposing to amend Rule 206(4)-2 and impose any requirements for advisers to use PCAOB registered and inspected audit firms for surprise exams and internal control reporting.

III. Guidance for Auditors

We have several comments on the guidance for auditors in conducting surprise exams and internal control reports. The applicable guidance for surprise examinations is the *Nature of Examination Required to be Made of All Funds and Securities Held in Custody of Investment Advisers and Related Accountant's Certificate* (Investment Advisers Act Release No. 201 and Accounting Series Release No. 103) promulgated in 1966. Needless to say, much has changed since 1966, and this guidance needs updating. For example, many new financial products have been created, which the guidance does not contemplate and fails to appreciate. In addition, the 1966 guidance requires the accountant must verify *all* or substantiate *all* client funds and securities covered by the examination. In updating the guidance, the SEC should reconsider this requirement and whether risk-based sampling would instead be a more cost-benefit effective approach. As it stands, the SEC's estimate of an additional annual cost to advisers of

$8,100, on average, for surprise exams appears woefully understated. It is our understanding that surprise audits are likely to cost between $20,000 and $300,00 for small and medium-sized advisers to over $1 million for the largest investment advisers.

The proposal calls for internal control reports to be rendered in accordance with PCAOB Interim Auditing Standard AU Section 324 (*Service Organizations*). As noted earlier, these reports are commonly referred to as Type II SAS 70 Reports. AU Section 324 (SAS No. 70) provides that the auditor's report may relate to whether such controls were suitably designed to achieve specified control objectives and whether the controls tested were operating with sufficient effectiveness to provide reasonable assurance the related control objectives were achieved during the period specified. AU Section 324 (SAS 70) provides that the control objectives may be designated by the entity itself or by outside parties such as regulatory authorities. To appropriately calibrate this requirement and obtain consistency across advisors and over time, the SEC should specify the control objectives it intends to be the focus of internal control reports for advisers.

AU Section 324, adopted by the PCAOB, was originally promulgated by the American Institute of Certified Public Accountants (AICPA) Auditing Standards Board (ASB) in 1993. More recently, the AICPA and the International Auditing and Assurance Standards Board (IAASB) agreed to converge their two sets of auditing standards, and are working to do so. We also understand that these standards-setters plan to update the 1993 guidance on SAS 70 reports, while the PCAOB has not announced any plans to do likewise. We concur with the ASB and IAASB that the guidance needs updating and the PCAOB needs to commit to doing so. Moreover, this situation illustrates the need for convergence of auditing standards.

As the CCMC has previously expressed, we encourage the PCAOB to embrace the convergence of auditing standards. In proposing its own standards for audits of issuers (that likewise apply to non-issuers in some circumstances, as illustrated by this proposal), the PCAOB fails to acknowledge the globalization of the economy and the unique needs these changes have imposed upon businesses and investors alike. Commonalities in the dissemination, reliability, and evaluation of financial information assist in the sound operation of markets.

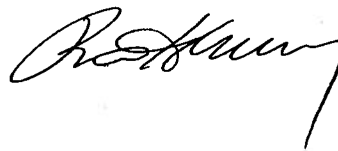
We encourage the Commission to take advantage of the opportunity afforded by this proposal to advance the convergence of international auditing standards.

Conclusion

The Chamber supports rational means to restoring investor confidence, yet is concerned that the proposed amendments will do little to address the issues raised by the recent frauds. We believe that the several initiatives underway at the SEC to strengthen the examination and enforcement functions and to increase the agency's ability to detect and deter fraudulent activity will significantly improve the effectiveness of the current regulatory safeguards. The proposed amendments would impose substantial costs on registered advisers without providing proportionate protections to clients, who will ultimately bear the additional costs. In light of the unbalanced cost-benefit analysis, nuanced and bifurcated approach to the use of independent public accountants, and outstanding decisions related to audit procedures and PCAOB jurisdiction, we urge the Commission to consider alternative, risk-based proposals that would provide additional safeguards for client assets without the negative and unintended consequences that the current proposal present.

We appreciate the opportunity to provide our thoughts on this matter and we would be happy to discuss this with the relevant SEC staff.

Sincerely,



Richard Murray
Chairman
Center for Capital Markets Competitiveness
U.S. Chamber of Commerce

cc: The Honorable Mary L. Schapiro, Chairman, U.S. Securities and Exchange Commission
The Honorable Luis A. Aguilar, Commissioner, U.S. Securities and Exchange Commission
The Honorable Kathleen L. Casey, Commissioner, U.S. Securities and Exchange Commission
The Honorable Troy A. Paredes, Commissioner, U.S. Securities and Exchange Commission
The Honorable Elisse B. Walter, Commissioner, U.S. Securities and Exchange Commission
Daniel L. Goelzer, Acting Chairman, Public Company Accounting Oversight Board
Bill Gradison, Member, Public Company Accounting Oversight Board
Steven B. Harris, Member, Public Company Accounting Oversight Board
Charles D. Niemeier, Member, Public Company Accounting Oversight Board