

August 7, 2009

Elizabeth M. Murphy, Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: SEC Release No. IA-2876; File No. S7-09-09  
Custody of Funds or Securities of Clients by Investment Advisors  
PROPOSED CHANGES TO RULE 206(4)-2

Dear Ms. Murphy:

**SURPRISE AUDIT PROPOSAL:**

Currently, RIAs who custody their client assets at qualified custodians that directly provide account statements to the clients are not subject to the annual surprise audit requirement under the Custody Rule. That requirement, where applicable, entails having an independent public accountant (i) confirm with the custodian all cash and securities held by the custodian and reconcile all such cash and securities to the books and records of client accounts maintained by the advisor, (ii) verify the books and records of client accounts maintained by the advisor by examining the security records and transactions since the last examination and by confirming with clients all funds and securities in client accounts, and (iii) confirm with clients, on a test basis, closed accounts or securities or funds that have been returned since the last examination. The results of the examination must be reported by the accountant to the SEC. By rulemaking action in 2003, the SEC eliminated the annual surprise audit of RIAs with respect to client accounts for which the RIA had a reasonable belief that a qualified custodian provided account statements directly to the clients at least quarterly.

I know that in all cases a broker-dealer custodian separately is subject to the annual audit requirements performed by PCAOB auditors. This is a major source of protection of RIA client assets. In addition, as a practical matter RIAs often will look to the broker-dealer records as to client asset details. Accordingly, we could support an alternative approach to enhancing RIA client protection as follows: (i) require RIAs to provide clients with detailed written notice of fee deductions being made through their qualified independent custodian, (ii) have the SEC issue clear guidance as to a maximum permissible fee rate that RIAs can withdraw from client accounts through their qualified independent custodians,

**SHOULD RIAs ONLY HAVING FEE WITHDRAWAL AUTHORITY BE EXCEPTED?**

In my view, RIAs whose only connection to client assets held at qualified custodians is the ability to withdraw advisory fees do not have true custody. The fee deduction test is an unnecessary regulatory stretch that would adversely affect me and about 6,000 of the

approximately 11,000 SEC registered advisors (as estimated at a recent SEC open meeting) in a manner disproportionate to any benefit that may be derived.

The SEC estimates in the Release an average surprise audit cost of \$8,100 to an RIA. This figure seems very low; however, even accepting that figure, the estimated 6,000 SEC registered advisors deemed to have custody only because of fee withdrawal authority would incur total aggregated annual costs of about \$48,600,000 (\$8,100 x 6,000) to comply with the surprise audit requirement. That represents a very high cost to cover a situation which is arguably a strained interpretation of "custody". The low risk of wrongdoing in this limited circumstance coupled with the audit requirements already in place for independent qualified custodians makes this cost unwarranted.

With respect to the estimated \$8,100 average audit fee, I would like to suggest that single owner/operator RIAs like myself, who do most if not all of the portfolio management personally, will find this requirement onerous, forcing higher fees to compensate for the higher cost, when a results oriented oversight process is already in place and fully adequate to the job of preventing excessive withdrawals of fees for client accounts.

#### EXAMPLE:

TD Ameritrade is the custodian of my clients' assets. I invoice my fees through TD Ameritrade directly to my client accounts. TD Ameritrade has instituted an oversight process whereby any fee charges greater than 3% of total assets is flagged and justification is required before processing. My maximum fee is 1.5% annually, and I invoice quarterly. The custodian oversight of this billing process is more than adequate for our purposes and should be sufficient to allow for proper controls of this "custody" exception to the rule.

#### AN ALTERNATIVE SUGGESTION

In order to prevent excessive, costly and unnecessary administrative oversight, I suggest that RIA organizations with assets less than some determined dollar amount, be exempted. (There has been serious consideration of a proposal to increase the SEC regulated RIA assets under management to \$100 million, from the current level of \$30 million, thereby leaving State supervisors the responsibility for supervisory oversight of those RIAs with fewer than \$100 million assets under management).

#### THE INDEPENDENT RIA MOVEMENT:

With the independence movement gaining momentum, more and more broker-dealer representatives are becoming independent RIAs and are taking their book of managed assets into private practice. These are small RIA practices and the number of independent RIAs is increasing at a very rapid rate. To administer this system is going to become more and more burdensome as the number of small offices proliferates. I know about this proliferation because I am one of those new independents. I left the wirehouse system

because I wanted a higher standard of ethics than I found acceptable at those companies ? Bear Stearns, Prudential, UBS. There are many like myself.

**STATEMENT OF PERSONAL COMMITMENT:**

I serve my clients in such a way that my explicit commitment to each is to act only to serve their best interest, with every action I take. This is the standard for independent RIAs, unlike the broker-dealer culture which puts company profit before all else.

**RECOMMENDATION:**

I strongly recommend that the definition of custody in the Custody Rule be revised to eliminate the fee deduction test as a basis for an advisor being deemed to have custody. I think the better approach would be to remove the fee deduction test as determinative of whether an RIA is deemed to have custody over client assets or securities.

Thank your for your consideration on this matter.

Sincerely,

Richard Brackett  
High Desert Investment Advisors, LLC