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To Whom It May Concern:

The proposed changes to the SEC rules involving making investment advisors pay for surprise audits on themselves is a classic example of an unwieldy and clumsy attempt to protect the investing public from a super micro-minority in the world of white collar crime. Unfortunately for the investment community, these criminals call themselves investment advisors in order to gain access to clients' assets. (They wouldn't be as efficient in their theft masquerading as interior designers or yoga instructors.) Thus, thanks to the choice of label, the regulators feel compelled to increase the regulatory burden on the legitimate members of the investment community as a response to criminal activity of a few dozen financial abusers that hold themselves out to the public as investment advisors.

Bernie Madoff and Robert Allen Stanford did NOT operate as legitimate investment advisors. Why punish an entire industry because a few criminals chose that label for their enterprise??????

Here are a couple straightforward solutions to the problem which would help protect the investing public without overburdening the legitimate investment advisors:

Change the definition of "custody" for accounts held at regulated third party custodians such as brokerage firms and/or trust companies

Due to a quirk of definition, an investment advisor who deducts fees directly from client accounts is deemed to have custody, even if those accounts are held at nationally known brokerage firms such as Charles Schwab and TD Ameritrade. Any account activity, including the fraudulent departure of assets, is captured in the custodian's computer system and reflected on the clients' monthly statement from the custodian. Thus, a legitimate third party custodian automatically creates a paper trail of the criminal activity.

Adding the cost and hassle of surprise asset audits for the entire industry would not do anything to prevent wrongful departure of assets from a client's account. The wrongful taking of client assets is a criminal act, and increasing the regulatory burden on the entire industry is not going to lessen the fact that a small number of people are dishonest and will steal from clients.

Increase public knowledge by disseminating information about the entire industry

Straightforward information including standard fee practices, industry average fees and descriptions of legitimate investment processes would help investors to make better decisions. In addition, basic checklists to help investors conduct due diligence and a list of Red Flag items would also help consumers avoid suspicious situations.

A more informed public would discourage some of the would-be criminals. Unfortunately, the current level of financial sophistication in the general public makes criminal and misdemeanor abuse relatively easy.

Increased investigation of Red Flag situations

Inevitably the exposure of a Madoff-like scam results in a list of Red Flags that existed months or even years prior to the actual arrest of a perpetrator. Regulatory investigation at the first appearance of a Red Flag would not only contain the criminal activity, but could also act as a strong deterrent.

Thankfully, one of the most telling Red Flags is virtually unhideable because the criminals use it to perpetuate their crime and lure in new victims. Ponzi schemes are not based in modestly above-average returns. Unbelievably good investment returns, especially over extended periods of time, are the essential indicator of ponzi schemes. Granted, Peter Lynch/Fidelity-type results are achievable, but the vast majority of investment advisors wouldn't qualify for investigation if unbelievably good investment returns were targeted as an investigation triggering item.

Combining the requirements of unbelievably good investment returns over time with lavish yacht-owning, exotic automobile driving, jet-setting lifestyles would be an effective screen. This is not to say that the regulators should require successful investment advisors to live like Warren Buffet, but it does serve as a cautionary note that high-flying behavior may be an indicator of something rotten at the core. Unsurprisingly part of the profile those who successfully bilked investors out of millions includes the proclivity to spend money like water (or like it wasn't theirs to spend).

In the unlikely event that an advisor achieves long term unbelievably good returns AND lives a lavish lifestyle, the resulting regulatory investigation should be considered as part of the price of achieving near statistically impossible success. If I were in that enviable position I would gladly endure the hassle of complying with a regulatory investigation. I would view it as a sacrifice for the greater good.

In addition, other Red Flags such as the custody of assets at a closely-held affiliated firm or the employment of a one-man audit firm may not indicate criminal activity, but DO indicate a greater potential for criminal activity. Again, using limited regulatory resources to investigate existing Red Flags would protect more consumers than hoisting additional regulatory requirements on the entire industry. This would also allow the regulators to focus resources on pursuing criminal investigations instead of hiring more regulators to monitor the increased reporting from increased requirements.

Enlist the active assistance of the entire financial community
Every community has a financial grapevine. Regulators should encourage legitimate financial services professionals to aid in the early detection and investigation of criminal activity. Since they are busy complying with regulations, they are among the most qualified to spot irregularities and potential abuses.

Set up safe harbor guidelines with reduced regulation
The average "plain-vanilla" investment advisor who trades mutual funds and listed securities with assets custodied at a third party brokerage firm does not need additional regulatory requirements to improve the level of her professionalism or service to clients. Subjecting these types of advisors to additional requirements creates an unfair burden to the advisors and increases costs which they subsequently pass on to clients.

These types of advisors are not perpetrating crimes on their clients. They should be allowed to exist with reduced regulation as long as they follow sound and safe practices in running their advisory businesses.

Establish a substantial reward for information leading to the discovery of a financial scam
By paying people to spot scams, the regulators effectively increase their eyes and ears. Setting up a large reward for the exposure of financial scams would be a great deterrent and might encourage whistleblowers. In addition, figuring out how to spot a scam in order to collect the reward is a good incentive to becoming a better informed consumer.

Smarter more targeted regulation, not more regulation
Smart regulators need to effectively evaluate the risks and potential for abuse within the entire industry and then increase their concentration on the riskiest areas. They need to trust in the fact that 99.9% or more of investment advisors are honest business people. They need to focus their efforts on the microscopic percentage of people who would use the label of investment advisor to trick consumers into giving up their assets.

Regulators need to re-evaluate their perspective in order to adapt to the realities of today's marketplace. Resources are at a premium and adding regulatory burdens to legitimate business is not good business practice. It just increases the costs and inefficiencies in the system.

Criminals are not concerned with complying with additional regulation. They will continue to steal if given the opportunity. Spreading already overtaxed regulatory resources over the entire industry instead of laser targeting potential wrongdoers basically preserves that opportunity.

Regulators need to quit treating the industries they regulate as a group of potential wrongdoers and start enlisting the help of intelligent financial professionals to help weed out the criminals before they grow their empires to billions of dollars of client assets. In the end, annually adding 16 hours of time burden and $8,100 in additional accountants' fees per investment advisor is not going to solve the problems caused by the Bernie Madoff's of the future.

Investment professionals need to raise strong and vociferous objections to yet another layer of regulation with questionable efficacy. Instead of dutifully filling out paperwork and paying increased accountants fees we need to persuade the regulators to re-focus their efforts toward successfully detecting and prosecuting financial scammers. They need to see that imposing more complex and costly regulations in their attempt to appease public outcry makes them look increasingly impotent. Catching financial scams early, throwing the perpetrators in prison, and publicizing successful prosecutions will do more to improve the industry and increase public confidence.

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