

I am writing to support the major thrust of Release No. IA-2876 File No. S7-09-09 and to register strong disagreement with one provision. The proposal to require that everyone who provides investment advice or manages money on behalf of clients use an independent custodian is excellent. It eliminates many of the conflicts of interest and much of the fraud risk that occurs when the custodian is controlled by or related to the advisor or money manager. After the start-up costs of implementing a switch to an independent custodian are incurred, the on-going future costs should be very similar to current arrangements. And the benefit to the consumer in more appropriate, honest, and cost-conscious advice would be very significant.

However, the proposal to require surprise audit examinations of advisors who deduct their fees from accounts held at an independent custodian on the grounds that the advisors have custody over client assets fails on grounds of logic and cost/benefit analysis.

- My understanding of the term “custody” is that it refers to the keeping of an asset. In the situation in which the advisor receives its fees from the client’s account at an independent custodian, that custodian has custody over the assets. The independent custodian releases the money to pay the fees from its custody and remits it to the advisor. At that point the fees become the advisor’s property. Never does the advisor have custody over the client’s assets.
- I am unaware of any case in which being able to deduct fees from a client’s independently custodied account was the sole cause of a fraud. There was always some other condition that allowed the advisor to perpetrate the fraud. The SEC’s proposal addresses many of those other factors.
- The direct cost of, in my view, an unnecessary surprise audit will be passed on to the client.
- The indirect cost of having the advisor’s time and energy misspent in responding to a surprise audit also will be passed on to the client.
- The surprise audit examination would be a wasteful duplication of independent custodian audit requirements.

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