Robert E. Frey, CFP
Lakeside Advisors, Inc.
1115 East Denny Way
Seattle, Washington 98122
206-285-1730 / FAX 206-267-2316

24 July 2009

VIA ELECTRONIC MAIL

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 Number S7-09-09

As the principal officer of registered investment advisor Lakeside Advisors, Inc., I would like to express my views of the proposed amendments to Rule 206(4)-2 (the "Custody Rule"), specifically the surprise audit requirement proposal.

While supporting the SEC's efforts to further protect the investing public, I oppose the surprise audit proposal in the context where Advisers use independent qualified custodians for their clients' assets or securities and who are only deemed to have custody because they have fee withdrawal authority.

As required by current Custody Rule, the independent qualified custodian maintaining our clients' accounts delivers account statements, on at least a quarterly basis, directly to our clients, identifying the amount of funds and securities at the end of the period as well as all activity in our clients' accounts. As a result, our clients receive comprehensive account information directly from the qualified custodian and are able to monitor the activity in their accounts. These safekeeping measures provide our clients with the ability to sufficiently identify and detect erroneous or fraudulent transactions.

Although Advisers such as ourselves are deemed to have custody because of fee withdrawal authority, clients' assets are held at an independent custodian which is already subject to annual audit requirements per-

formed by an independent public accountant. As a result, mandating surprise audits of firms like ours by an independent public accountant would provide little benefit to our clients, but the costs to Advisers would be substantial.

I understand that of the approximately 11,200 Advisers regulated by the SEC, only a dozen or two possessed the kind of "actual" custody enjoyed by Bernard Madoff and his companies. We read that there are approximately 9,575 Advisers who are deemed to have custody because they have fee withdrawal authority, the majority of which advisers likely enjoy no rights other than a limited power of attorney to rearrange assets.

The Ponzi schemes uncovered recently by the SEC had nothing to do with the fees deducted by Advisers. As far as I am aware, there have been no systemic problems in this area of fee deduction and the proposed rule is unnecessary, costly and burdensome, particularly for small, independent Advisers such as ourselves.

By way of education, since that is why you are seeking these comments, some independent custodians may act as a "Prime Broker," in which case, the Adviser's ability to totally control client assets is elevated to an extreme level far beyond fee deduction and asset rearrangement. It is thus important to make this distinction in your rulemaking. <u>Advisers with assets in custody of a prime broker should not be exempted from the surprise audit requirement</u>.

I respectfully request that the surprise audit requirement for most Advisers who have "technical custody" be withdrawn. Instead, I propose alternative measures to enhance investor protection such as:

- **(i) Require RIAs to give fee notifications to clients at or about the time fees are withdrawn from client accounts through independent custodians**
- **(ii) Provide clear fee guidance as to the maximum permissible advisory fee rate that an RIA can deduct through independent custodians**
- **(iii) Conduct more frequent inspections of Advisers, with major focus on those with actual custody matters, including those who use Prime Brokers for custody.**
- **(iv) Require RIA chief compliance officers to conduct an annual custody review and related certification to the SEC**

If the above or a similar approach is taken, I believe that the Custody Rule should be revised to eliminate the fee deduction authority test as a basis for establishing advisor custody for the majority of Advisers.

I thank you for the opportunity to comment on this matter.

Respectfully,

Robert E. Frey Jr., CFP
President
Lakeside Advisors, Inc.