To the SEC regarding Custody of Funds or Securities of Clients by Investment Advisers

First, this proposed requirement appears to be an outgrowth of the publicity surrounding the massive fraud of the Madoff Ponzi schemes. As such, the requirement for all investment advisers to be subject to annual surprise exam does not address the underlying causes of that scam: the failure to require separate custody arrangements from trading and statement reporting; the failure of the SEC to properly investigate legitimate leads about the potential scam; the failure of the system to regulate hedge funds or other types of entities designed to evade regulatory scrutiny; and the enormous gullibility of investors.

For those of us with a small client base (less than $100,000,000) the cost of an annual surprise audit by an accountant is prohibitive and does little to prevent fraud. Even for larger institutional accounts, I doubt that a surprise audit will uncover the kinds of abuse that you mention in your release. This type of audit will not prevent the unscrupulous adviser from perpetrating and hiding fraud. Dare I mention that Enron was audited and that we saw only what the auditors saw—not what was “off balance sheet?”

Furthermore, adding fraud detection to the list of duties for the CCO is not going to accomplish the task either. Do you really think that the CCO will be able to freely investigate such problems at his/her firm without being fired? Even a hint that the CCO suspects fraud and is investigating this possibility is going to close down all avenues to finding it.

If you do put this onerous rule in place, I would **strongly recommend** an exemption for advisers who maintain custody by virtue of merely withdrawing fees and for advisors with no history of enforcement actions or complaints with the SEC or other local regulatory bodies

It seems to me that requiring a random sample of clients at firms to verify the accuracy of their statements and funds withdrawn would go a long way to uncovering some types of abuse a little sooner. Often clients seem oblivious to activity on their account and do not look at their statement in any detail. This is the most obvious place to begin the fraud detection process.

Finally, the alternate proposal of requiring advisers to use independent custodians would address many of the concerns you have voiced.