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July 29, 2009

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Request for Comment on Proposed Amendments Under the Investment Advisers Act of 1940 Regarding Custody of Funds or Securities of Clients by Investment Advisers; File No. S7-09-09

Dear Ms. Murphy:

We submit this letter in response to the specific requests of the Securities and Exchange Commission (the "Commission") in Release No. IA-2876 (the "Release")[1] for comment on proposed amendments to rule 206(4)-2 under the Investment Advisers Act of 1940, as amended (the "Advisers Act"),[2] which would increase oversight of investment advisers registered or required to be registered under the Advisers Act ("advisers") that have custody of client funds or securities (the "Proposal").[3]

Seward & Kissel LLP represents a substantial number of clients who serve as advisers and who have custody of client funds or securities within the meaning of the Custody Rule. We appreciate the opportunity to comment on the Release, especially considering that the Proposal, if adopted, would significantly affect the business of many of our clients. The views we express in this letter, however, are our own and do not necessarily reflect those of our clients.

We respectfully submit the following comments and request that the Commission consider them before adopting the Proposal.

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[1] Custody of Funds or Securities of Clients by Investment Advisers, Advisers Act Release No. 2876, 74 Fed. Reg. 25,353 (proposed May 20, 2009) (to be codified at 17 C.F.R. pts. 275 and 279).

[2] Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 - 80b-21 (2008).

[3] For convenience, this letter refers to rule 206(4)-2 under the Advisers Act, as the "Custody Rule."

I. Proposed Amendments to the Custody Rule

In recognition of the recent enforcement actions against advisers and broker-dealers alleging fraudulent conduct, including misappropriation or other misuse of investor assets, the Commission has indicated that it is undertaking a comprehensive review of the rules regarding the safekeeping of investor assets in order to determine changes it might make that would decrease the likelihood that client assets are misused, or would increase the likelihood that fraudulent activities are discovered earlier and client losses are thereby reduced.[4] The Commission has explained that the Proposal is designed to improve the safekeeping of client assets.[5]

While we are mindful of these recent enforcement actions, we disagree with certain of the requirements to be imposed under the Proposal and we believe that the Commission can better achieve its goals by adopting alternative requirements. Further, we recommend that the Commission clarify, modify and expand certain terms in the Proposal or the Custody Rule.

II. The Commission Should Eliminate the Proposed Surprise Examination Requirement in Certain Circumstances

A. Advisers That Have Custody Solely as a Result of Their Management of Pooled Vehicles That Are Subject to Annual Audit Should be Excepted From the New Exam Requirement

The Custody Rule requires a surprise examination (the "Current Exam") only under circumstances in which an adviser that has custody of client assets, rather than a qualified custodian, sends quarterly account statements to clients.[6] The Proposal, however, requires that all advisers with custody of client assets engage an independent public accountant to conduct an annual surprise examination of client assets (the "New Exam").[7] The Commission requests comments as to whether the New Exam requirement would increase protections afforded to advisory clients (including pooled investment vehicles and investors in those vehicles).[8] The Commission believes that the New Exam by an independent public accountant would provide "another set of eyes" on client assets, and thus additional protection against misuse.[9]

We believe that the New Exam requirement would be duplicative for advisers that have custody of client assets by virtue of their management of pooled vehicles that are subject to annual audit. The New Exam would confirm the existence of client assets, which in part, would also confirm the existence of pool assets, in addition to any annual audit of the pool that is

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[4] *Release*, at 25,355.

[5] *Id.*

[6] 15 U.S.C. § 206(4)-2(a)(3).

[7] *Release*, at 25,355-56.

[8] *Release*, at 25,356.

[9] *Id.*

performed at the end of each fiscal year.[10] We believe that in this circumstance, the New Exam requirement, will not prevent the misuse of client assets more effectively than the presently required annual audits.

The Commission estimates that advisers would pay, on average, an annual accounting fee of $8,100 for the New Exam.[11] We do not believe that the Commission has sufficiently set forth objective evidence to substantiate this figure and request that the Commission substantiate its estimate.[12] Our concern is that ultimately clients will bear this expense.

The Commission asks whether the New Exam should be conducted more frequently than annually.[13] As we do not believe that the New Exam requirement would provide any new meaningful protections to advisory clients whose advisers have custody of client assets by virtue of their management of pooled vehicles subject to annual audit, we do not believe that conducting the New Exam more frequently than annually would benefit such advisory clients.

B. Advisers That Have Custody Solely as a Result of Their Authority to Withdraw Advisory Fees Should be Excepted From the New Exam Requirement

The Commission solicits comments on whether it should except from the New Exam requirement advisers that have custody solely as a result of their authority to withdraw advisory fees.[14] We believe that such advisers should be excepted from the New Exam requirement because the New Exam is meant only to verify client funds and securities. Since such advisers do not have actual custody of such client funds and securities, the New Exam would be pointless in such cases.

Neither the Custody Rule nor the Proposal requires advisers to send account statements directly to clients when deducting fees from clients' accounts.[15] As an alternative to the New Exam requirement, we believe that the Commission can better achieve its stated

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[10] *Release*, at 25,368. In addition, the Commission acknowledges in the Release that advisers with custody that are registered broker-dealers are currently required to undergo annual audits sufficient for auditors to provide reasonable assurance that material inadequacies do not exist in the broker-dealer's procedures for safeguarding securities. *Release* at 25,356.

[11] *Release*, at 25,370.

[12] The Commission explains that the estimate is consistent with its 2003 amendment to the Custody Rule in which it estimated that an adviser would pay an accountant $8,000 to conduct the Current Exam. *Release,* at 25,365 n.102. We do not understand how the estimate can vary by only $100 over a six year period. Additionally, in estimating accounting costs, the Commission should consider that accounting costs will vary based on factors such as the size and scope of advisory businesses, as well as whether the accountant that performs the New Exam would be required to be registered with the Public Company Accounting Oversight Board, pursuant to Proposed Rule 204(4)-2(a)(6)(B).

[13] *Release*, at 25,356.

[14] *Id.*

[15] *See Release*, at 25,361.

purpose of providing additional protections to advisory clients by reimplementing certain previous staff interpretations. As an alternative to a New Exam requirement for such advisers, we suggest that the Proposal be revised to require that an adviser that has custody solely as a result of its authority to withdraw advisory fees send to the client and the custodian at the same time a bill showing the amount of the fee, the value of the client's assets on which the fee was based, and the specific manner in which the adviser's fee was calculated. This would allow advisory clients to monitor fee deductions.

C. The Term "Material Discrepancy" Should be Clarified

The Proposal would require that the accountant who performs the New Exam notify the Commission within one business day of finding "material discrepancies."[16] We request that the Commission provide guidance on the definition of the term.

D. The Independent Public Accountant's Termination Statement Should Not be Publicly Available

The Commission solicits comments on whether the independent public accountant's termination statement that would be required to be filed with the Commission should be made publicly available.[17] We believe that termination statements should not be publicly available because the public disclosure of the details of the accountant's resignation, dismissal, removal or other termination can easily be misinterpreted.

III. The Definition of "Fund of Funds" Should be Expanded and Included in the Custody Rule

The Proposal does not include the definition of "fund of funds," nor does it provide the 180-day time period for a fund of funds relying on the exemption to the account statement delivery requirement to deliver the audited financial statements of its pooled investment vehicles.[18] We request that the Commission take this opportunity to once again include these concepts in the Custody Rule.

Furthermore, we recommend that the Commission broaden the definition of "fund of funds" put forth in the 2004 Release to include pooled investment vehicles that invest ten

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[16] *Release*, at 25,357.

[17] *Release*, at 25,358.

[18] Pursuant to a 2004 release (the "2004 Release"), the Commission provided fund of funds advisers the extended 180-day time period due to the practical difficulties they face in obtaining completion of their audits prior to completion of the audits for the underlying funds in which they invest. *See* Registration Under the Advisers Act of Certain Hedge Fund Advisers, Advisers Act Release No. 2333, 69 Fed. Reg. 72,054 at 72,076 (2004). Although the rules adopted by the 2004 Release were vacated, in 2006 Commission staff confirmed the continued validity of the 180-day time period adopted by the 2004 Release. *See* American Bar Association, SEC No-Action Letter, 2006 SEC No-Act. LEXIS 570 (Aug. 10, 2006).

percent or more of their total assets in other pooled investment vehicles, directly or indirectly, that are not, and are not advised by, a related person.

IV. Preservation of Account Statement Delivery by Adviser Alternative

The Commission requests comment as to whether it should eliminate the alternative account statement delivery option under which the adviser may deliver quarterly account statements to clients provided under the Custody Rule.[19] We request the Commission to continue to include the alternative account statement delivery option provided under the Custody Rule. This alternative option is important for advisers with advisory clients using multiple custodians who receive multiple account statements from different custodians.

V. Eliminate the Liquidation Audit Requirement

The Commission asks for comments regarding the clarification in the Proposal that specifically requires an adviser to a pooled investment vehicle that is relying on the annual audit exception, to obtain a final audit if the pool is liquidated at a time other than the end of its fiscal year (the "Liquidation Audit").[20] Pooled investment vehicles may liquidate at various times during their fiscal years. The Proposal would require pools to obtain audits for "stub periods," covering the period from the pool's last audit to the time of liquidation. The financial burden of the Liquidation Audit would be borne by investors. We request that the Commission eliminate or permit investors to waive the Liquidation Audit requirement because we believe that the final tax return and most recent annual audit delivered to investors provide adequate protection.[21]

VI. The Definition of "Qualified Custodian" Should be Expanded

The Custody Rule and the Proposal define a "qualified custodian" to include a foreign financial institution that customarily holds financial assets for its customers, provided that the foreign financial institution keeps the advisory clients' assets in customer accounts segregated from its proprietary assets.[22] We believe that the current definition of "qualified custodian" with respect to foreign financial institutions imposes United States regulatory standards in jurisdictions outside the United States and creates impediments to trading outside the United States. We request that the Commission expand this definition to reconcile it with the current custodial practices of foreign financial institutions by eliminating the requirement that foreign financial institutions keep clients' assets in segregated customer accounts.

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[19] *Release*, at 25,361.

[20] *Release*, at 25,362.

[21] We additionally suggest that if the New Exam requirement is adopted, the Commission consider excepting therefrom advisers whose advisory clients have unanimously consented to waive the New Exam requirement.

[22] 17 C.F.R. § 275.206(4)(c)(3)(iv); *Release*, at 25,375.

In its 2003 release adopting the Custody Rule and the Release, the Commission recognized that foreign custody arrangements may be necessary to permit clients to trade in securities traded in foreign markets, or to accommodate clients with existing relationships with foreign institutions.[23] In these prior statements, the Commission indicated that when an adviser selects a foreign financial institution to hold clients' assets, the adviser's fiduciary obligations require it either (i) to have a reasonable basis for believing that the foreign institution will provide a level of safety for client assets similar to that which would be provided by a "qualified custodian" in the United States or (ii) to fully disclose to clients any material risks attendant to maintaining the assets with the foreign custodian.[24] These statements acknowledge that foreign financial institutions are subject to standards that differ from those standards applicable to U.S. regulated banks, broker-dealers and futures commission merchants and provide advisers with some flexibility in selecting a foreign financial institution to serve as a qualified custodian. Accordingly, we urge the Commission to be mindful that many foreign jurisdictions do not require foreign financial institutions to keep their advisory clients' assets in customer accounts segregated from proprietary assets and request that the Commission define "qualified custodian" to include any foreign financial institution that is qualified and authorized to conduct business as a financial institution under the laws of its local jurisdiction.

We appreciate the opportunity to comment on the Release. If you have any questions regarding this letter, please contact the undersigned at the telephone numbers indicated below.

Very truly yours,

/s/ Patricia A. Poglinco
Patricia A. Poglinco
212.574.1247

and

/s/ Robert B. Van Grover
Robert B. Van Grover
212.574.1205

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[23] Custody of Funds or Securities of Clients by Investment Advisers, Advisers Act Release No. 2176, 68 Fed. Reg. 56,692 at 56,694 n.22 (October 1, 2003) (codified at 17 C.F.R. pts. 275 and 279); *Release*, at 25,354 n.3.

[24] *Id.*