

April 30, 2009

The Honorable Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Dear Chairman Schapiro:

We are writing regarding your recent testimony before the United States Senate Committee on Banking, Housing and Urban Affairs (March 26, 2009) and your address to the Council of Institutional Investors (April 6, 2009). Both your testimony and the address focused on possible SEC solutions to oversight problems in the financial services sector – some of which may require legislation – including potential changes to the custody rule for investment advisers, third-party audits of advisers, and internal firm controls.

The Financial Planning Association (“FPA”)¹ is the largest advocacy organization in the United States representing financial planners and has long supported high standards of investor protection. Most of FPA’s 28,000 individual members are affiliated with SEC registered investment advisers or with broker-dealers.² FPA was pleased with your emphasis on investor protection in your testimony and address, and we look forward to supporting your efforts to enhance the SEC’s capabilities to protect the investing public.

The Commission’s agenda, as presented, does not include much detail, and we understand the staff is currently working on converting these concepts into a detailed rulemaking proposal. However, FPA would like to take this opportunity to share our thoughts on a few of the agenda

¹ The Financial Planning Association is the largest organization in the United States representing financial planners and affiliated firms, with approximately 28,000 individual members. Most are affiliated with investment adviser firms registered with the Securities and Exchange Commission or state securities administrators, and more than one-half are affiliated with broker-dealers. FPA is incorporated in Washington, D.C., where it maintains an advocacy office, with headquarters in Denver, Colo.

² Most FPA members are also Certified Financial Planners™ (CFP®) and are subject to fiduciary standards as a condition of certification. CFPs® must comply with the Certified Financial Planner Board of Standards *Rules of Conduct*, which include requirements regarding the identification of client assets over which the certificant takes custody or exercises discretion.

items that could have a significant effect on financial planners. In particular, we would like to address the agenda items related to investment adviser custody issues.

1) Requiring those with custody of client assets to undergo an annual third-party audit, on an unannounced basis, to confirm the safekeeping of those assets.

Rule 206(4)-2 requires an investment adviser who holds custody of clients' funds and securities to undergo a surprise audit, conducted annually by an independent public accountant, to verify the funds and securities. Because a surprise independent audit is already required of advisers maintaining custody of client funds ("self custody"), we understand this proposal to apply to advisers who custody funds with a qualified custodian and/or to qualified custodians. Currently, advisers using a qualified custodian are not subject to the surprise audit.

With the spate of Ponzi schemes that have recently come to light – most notably those involving Bernie Madoff and Allen Stanford – the Commission's focus on custody issues is timely and appropriate. Having the ability to verify investor's assets, whether by the SEC, by auditors or by clients themselves, is the best way to expose Ponzi schemes early on, minimizing investors' losses and weeding out criminals.

If the Commission is suggesting advisers who custody funds with a qualified custodian should be subject to a surprise annual audit, FPA has some questions and concerns. The cost of an annual audit for advisers can be significant and is a particular concern for smaller advisers who are less able to absorb those costs. We fully recognize that compliance costs are a necessary price to pay to help ensure investor protection. The scale of the Madoff scheme, on the surface, would seem to suggest that even significant costs would be justified to protect investors from such a large scale fraud. However, it is not clear how expanding the surprise audit to cover advisers who do not actually hold custody would materially enhance investor protection. With the qualified custodian being in possession of the clients' funds and sending statements directly to investors, an audit of the adviser would reveal no direct verifying information regarding the funds. It would seem to be a rather indirect and incomplete way to verify client funds. Because the audit would seem unlikely to produce direct information bearing on investor protection, FPA believe expanding the audit requirement in this way would not justify the costs that would be incurred, particularly for smaller firms.

If the Commission is suggesting that qualified custodians be subject to the annual surprise audit, FPA has some of the same concerns as for an audit of the investment adviser, though perhaps to a lesser extent. An investment adviser with self-custody is currently subject to an annual surprise audit. If the intent is to verify client assets, it is sensible that a qualified custodian should undergo the same or similar annual process for verification. Under Rule 206(4)-2, a qualified custodian can be a bank, a broker-dealer, a futures commission merchant or a foreign financial institution. The lack of an annual surprise audit requirement is justified, therefore, to some extent because the qualified custodian would be otherwise subject to regulatory supervision. But

if that supervision is insufficient to verify client assets on a regular basis, the lack of an audit requirement would appear to be a gap that needs to be addressed.

To the extent an audit requirement for qualified custodians would be redundant of supervision that is already adequate to verify client assets on a regular basis, FPA would question whether there is any investor protection value added that would warrant the costs and business disruption. However, if the SEC's proposal is targeted only to filling gaps in verifying client assets, we believe it is worthwhile.

In sum, at least at the conceptual level, FPA is concerned that this proposal could simply be an additional regulatory burden and expense with little or no commensurate enhancement of investor protection. We are concerned in particular for smaller firms that are less able to absorb the related costs and deal with the disruption of business. However, we will welcome the opportunity to learn more details on how the audit requirement would be expanded and how the SEC believes it can help improve investor protection, a goal FPA shares with the Commission.

2) Mandating that certain investment advisers have third-party compliance audits to ensure their compliance with the law.

It is not clear which investment advisers would be covered by this proposal. Is the intent to target only those with custody, or a broader segment of investment advisers? Regardless, FPA is concerned that firms subject to the requirement would incur a significant added expense, with little tangible benefit to investor protection.

We have read the myriad stories of past year about fraud, incompetence, greed, poor risk management, and lack of effective oversight, among other ills within the financial system. It is notable, we think, that investment adviser compliance with the law was not at issue in any significant way. Despite criticisms that there is too little oversight of adviser activities, the problems in the financial marketplace have not resulted from investment advisers' failure to follow the law and have effective compliance programs. Even in the case of Bernie Madoff, which has been inaccurately portrayed as an "investment adviser" issue, the fraud appears to have begun many years before as a broker-dealer under FINRA supervision.

If the idea of the proposal is to target advisers with custody to check compliance with relevant laws, we support the SEC's goal, but question the value to investors. Early detection of theft or misallocation of funds will best be determined through audits of the accounts, not through audits of compliance programs. There is certainly a benefit to evaluating an investment adviser's compliance program, but SEC staff is best suited to carrying out that function and we would support increasing resources for the SEC to do so effectively. But, annual or periodic third party audits of compliance programs seems to be an unnecessary cost, with little or no enhancement of investor protection to justify the expense and business disruption, especially for smaller firms.

3) Requiring a senior officer from each firm to attest to the sufficiency of the controls they have in place to protect client assets.

A requirement that a senior officer attest to controls is another way to help ensure the safety of client assets. But again, FPA is concerned that the costs to the firms are not justified by the tenuous and indirect enhancement of investor protection. The rationale, we presume, is that senior management would have added incentive to ensure controls were sufficient to protect client assets if a senior officer were compelled to attest to the adequacy of the controls. While there is logic to this argument, we believe management already has sufficient incentive to safeguard client assets. No firm wants to have its client's assets misallocated. However, the notable exception is when management itself intends to defraud clients, in which case any attestation will not serve as a deterrent. In fact, the recent highly publicized Ponzi schemes have been perpetrated not by low- or mid- level investment adviser representatives sneaking around inadequate controls. They have been perpetrated by the same senior management that would be expected to attest to the sufficiency of controls. Periodic, quality audits, whether by the SEC or independent third parties, is a much surer way to safeguard client assets.

On its face, an attestation is seemingly a minor matter, requiring firms to expend little in order to comply. Presumably the senior officer performing the attestation would seek some assurances from internal or external experts and compliance professionals that the firm's controls are adequate. To a certain degree, this may be a justifiable cost. However, Sarbanes-Oxley serves as a good recent lesson. Broadly, section 404 of the Sarbanes-Oxley Act of 2002 requires senior management of public companies to assess the adequacy of a company's internal controls over financial reporting, and the company's external auditor must attest to management's assessment. While there has been vigorous debate about wisdom and effectiveness of these requirements, there is little question that companies have incurred significant expense to comply with Sarbanes Oxley mandates. Though the Commission's proposal is seemingly much narrower in scope and smaller in scale than the Sarbanes Oxley requirements, it seems likely the same compliance dynamic will play out. Facing possible liability as a senior corporate executive, the attesting officer will likely expend significant resources – perhaps more than necessary - to reassure himself or herself of the adequacy of compliance controls. And again, it is the smaller firms that will find it more difficult to bear that burden.

While the goal and even, perhaps, the results are laudable, FPA believes the potential and likely costs are not balanced by a commensurate increase in investor protection. Investment advisers have sufficient business and regulatory incentive to ensure adequate controls for the protection of client assets, absent fraudulent or criminal intent. Therefore, FPA does not believe the attestation requirement would enhance investor protection in any meaningful way.

FPA appreciates your consideration of our thoughts on these proposals. They are necessarily conceptual as we await greater detail on the proposals. Nonetheless, we hope our comments are

helpful as you consider these matters which would significantly affect our member's business and compliance costs and operations. We would welcome the opportunity to discuss these issues in greater detail with SEC staff, and look forward to providing comments when more details on these proposals are available.

Very truly yours,

A handwritten signature in black ink, appearing to be 'DB', with a long horizontal line extending to the right.

Daniel Barry
Director of Government Relations