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About Allen Matkins

Allen Matkins Leck Gamble Mallory & Natsis LLP is a California law firm with more than 230 attorneys practicing out of seven offices in Los Angeles, Century City, Orange County, Del Mar Heights, San Diego, San Francisco and Walnut Creek. The firm's broad based areas of focus include corporate, real estate, construction, real estate finance, business litigation, employment and labor law, taxation, land use, bankruptcy and creditors' rights, intellectual property and environmental.

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Securities and Exchange Commission Proposes To Amend Investment Adviser Custody Rule

The SEC's proposal will affect registered investment advisers with custody of client funds.

[Click here to view the proposal.](#)

The Securities and Exchange Commission is proposing to amend its "custody rule" under the Investment Advisers Act of 1940. This proposal is coming in the aftermath of a number of well publicized enforcement actions by the Commission against investment advisers, including Bernard Madoff and Stanford Group Company.

The Custody Rule

The Commission adopted the custody rule in 1962. As adopted, the rule had required each investment adviser with custody of client securities or funds to engage an independent public accountant to conduct an annual surprise examination. Forty years later, the Commission amended the custody rule to eliminate the annual surprise examination requirement when an adviser had a reasonable belief that a "qualified custodian" provided account statements directly to its clients. Qualified custodians under the rule include banks, registered broker dealers and others that are subject to regulation and oversight. Accordingly, the Commission believed that delivery of account statements by qualified custodians would provide necessary information to clients and deter advisers from fraudulent activity.

The Commission is now revisiting its 2003 decision. It is proposing to require all investment advisers with custody of client assets to submit to an annual surprise examination regardless of whether a qualified custodian directly provides

statements to clients or, in the case of a pooled investment vehicle, the pool is audited at least annually and timely distributes financial statements (the proposed rule would continue to except these advisers from the requirement to have a qualified custodian send account statements to clients). The surprise examination requirement would also extend to advisers who are also registered broker-dealers (and thus permitted to act as qualified custodians for their clients' assets). The Commission is also proposing to provide that if an adviser or a related person serves as a qualified custodian for client funds or securities (i.e., an independent custodian does not maintain client assets), the adviser must obtain no less frequently than once each calendar year a written internal control report that includes an opinion from an independent public accountant registered with the Public Company Accounting Oversight Board.

Proposed changes to the rule

The changes described above are part of a nearly 100 page release which is [available here](#). In that release, the Commission is proposing numerous other changes affecting investment advisers, including changes to Part 1A and Schedule D of Form ADV. The comment period for the proposed rule changes ends on July 28, 2009.

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