

Warshaw Burstein Cohen Schlesinger & Kuh, LLP

MEMORANDUM

To: Our Clients and Friends **Date:** January 8, 2010
From: Warshaw Burstein Cohen Schlesinger & Kuh, LLP
RE: SEC Adopts New Amendments to the Custody Rules

On December 30, 2009, the Securities and Exchange Commission (the "SEC") published amendments to the custody and recordkeeping rules under the Investment Advisers Act of 1940 (the "Advisers Act") which will go into effect on March 12, 2010. Amendments also were made to certain related forms.

While the amendments are significant, the final amended custody rules (the "Custody Rules") contain numerous exceptions. As a result of these exceptions, the impact of the application of the new Custody Rules to investment advisers of private investment funds will be considerably less than if the SEC had adopted the rules in the form it proposed last May. This firm had submitted to the SEC a detailed comment letter on the proposed rules and we were gratified to see that all our recommendations were adopted and that our comment letter was cited three times in the SEC Interpretive Release adopting the Custody Rules.

Under the Custody Rules, registered investment advisers having "custody" (which is defined broadly under the Custody Rules) of clients' cash or securities are required to undergo an annual surprise examination. In this examination an independent public accountant, pursuant to a written agreement, will verify the cash and securities (including privately held securities) over which the adviser has custody. This requirement does not apply to investment advisers that have custody of client funds or securities solely as a result of their authority to have fees deducted from client accounts, provided that the qualified custodian maintaining the accounts is either not related to the adviser or is operationally independent of the adviser. Further, an adviser to a private investment fund will be deemed to satisfy this requirement, in respect of the cash and securities held by the fund, if it provides financial statements that have been audited by an independent public accountant registered with, and subject to inspection by, the Public Company Accounting Oversight Board (a "PCAOB Accountant") to each investor in the fund within 120 days of its fiscal year end (or, pursuant to an SEC Staff letter and the adopting release, 180 days in the case of a fund of funds) and upon liquidation of the fund. The liquidation audit is a new requirement.

The Custody Rules now mandate that the quarterly account statements required to be sent to clients must be sent by the custodian rather than the adviser. However, advisers to private investment funds that provide audited financial statements to their investors as described above are not required to comply with this provision with respect to those private investment funds.

New provisions of the Custody Rules require, where the qualified custodian of client funds or securities is not independent of the adviser, that an internal control report must be prepared by a PCAOB Accountant on an annual basis. An example of such a report is a Type II SAS 70 report; however, the Custody Rules require that the PCAOB Accountant must confirm that the clients' funds and securities are reconciled to a custodian that is independent of the adviser. The Custody Rules also require that the report contain an opinion of the PCAOB Accountant as to the existence of controls suitable and effective for safeguarding client assets.

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The foregoing is a synopsis of the key provisions of the Custody Rules. If you are interested in discussing the Custody Rules in more detail or the application of the Custody Rules to your business, please contact Janet R. Murtha at (212) 984-7731.