

MEMO# 35241

April 13, 2023

Your Comments Requested by COB April 21 - ICI Draft Letter on Safeguarding Advisory Client Assets Proposal

[35241]

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TO: Investment Advisers Committee

SEC Rules Committee

Securities Operations Advisory Committee RE: Your Comments Requested by COB April 21
- ICI Draft Letter on Safeguarding Advisory Client Assets Proposal

Attached for your review is ICI's draft comment letter on the SEC proposal regarding Safeguarding Advisory Client Assets, proposed on February 15, 2023.

Comments are due to the SEC on this proposal by Monday, May 8. The draft letter includes several areas where ICI seeks member feedback. To ensure that we have sufficient time to incorporate or address your views before May 8, please provide me with any feedback or comments by email at joshua.weinberg@ici.org no later than COB Friday, April 21. The draft letter is summarized immediately below.

Areas of Support

ICI expresses general support for the Proposal's investor protection goals and also supports the SEC excepting accounts of registered investment companies from the proposed rule, and recommends that business development companies be similarly excepted.

Areas of Opposition

ICI opposes the SEC expanding the definition of assets in a manner that would make custody impractical, or even impossible, for certain assets and disrupt current custodial arrangements. We particularly object to the Commission effectively requiring advisers to negotiate numerous contractual arrangements with custodians that would contain Commission-mandated provisions; equating an adviser's discretionary authority over a client account with having custody of client assets; and imposing on custodians an effective obligation to approve an adviser's client transactions on a pre-trade basis. In so doing, the Commission would be imposing requirements on entities beyond its authority and improperly mandating that certain terms appear in commercial agreements between

private contracting parties.

In addition, we oppose the Commission requiring advisers to determine the sufficiency of the financial strength of foreign financial institutions and assess the adequacy of international anti-money laundering and other bank-related legal requirements. We also oppose the Commission requiring advisers to secure services from independent public accountants that may go so far as requiring the accountants to be perpetually on call to perform certain obligations.

More generally, ICI is concerned that the Proposal fails to sufficiently consider the burdens of the proposed requirements on registered investment advisers, particularly smaller advisers, neglects to sufficiently incorporate information necessary for an adequate cost-benefit analysis, and does not consider the total impact of this rulemaking on market participants in conjunction with the many other outstanding Commission proposals.

To address these concerns, we make the following recommendations:

- We recommend that the SEC heed the lessons of prior rulemakings in the custodial space. The Commission previously engaged in custody-related rulemaking without fully understanding its implications. These prior efforts elicited significant industry concerns and resulted in the Commission delaying, then suspending, compliance dates for certain newly-imposed custodial requirements and ultimately issuing new proposals responding to the concerns raised.
- We identify a number of problematic elements associated with the proposed requirement for a written agreement between an adviser and a qualified custodian and associated receipt of reasonable assurances by the adviser, and recommend that these requirements be removed from any final rule.
- We recommend that the SEC remove the requirement for advisers to make certain determinations with respect to foreign financial institutions.
- We identify a number of issues with the proposed definition of "possession or control" and recommend that the SEC modify the definition to be consistent with current regulatory requirements applicable to custodians.
- With respect to crypto assets, we suggest that the SEC should be open to facilitating greater investor access to potentially beneficial investment opportunities.
- We recommend that any final rule include a "safe harbor" such that advisers who maintain appropriate policies and procedures that establish the frequency with which the market for custodial services is reviewed will be deemed to "reasonably determine" that the protections of a qualified custodian are unavailable for certain physical assets and privately offered securities.
- We recommend that the requirement for an independent public accountant to verify the existence and ownership of every holding, as well as the requirement that the independent public accountant verify each transaction in a privately offered security, be removed from any final rule.
- We identify a number of concerns and questions related to the use of certain derivatives instruments and recommend that the SEC address the custody of financial contracts (such as over-the-counter swaps, cleared swaps, futures contracts and option contracts) explicitly in any final rule.
- We recommend that the SEC provide for a significantly longer transition period for both larger and smaller advisers.

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