Money Management Institute

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Submitted electronically through rule-comments@sec.gov

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Comment on Proposed New Rule re: Safeguarding Advisory Client Assets [File Number S7-04-23]

Dear Ms. Countryman:

The Money Management Institute ("MMI") appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or the "Commission") in response to its request for comment on proposed new Rule 223-1 under the Investment Advisers Act of 1940 (the "Proposal").[1]

MMI is the national organization for the advisory solutions industry, representing a broad spectrum of advisers that manage separate accounts as well as sponsors of investment consulting programs. MMI was organized in 1997 to serve as a forum for the industry's leaders to address common concerns, discuss industry issues, and work together to better serve investors. Our membership comprises firms that offer comprehensive financial consulting services to individual investors, foundations, retirement plans, and trusts; related professional portfolio-management firms; and firms that provide long-term services to sponsor, manager, and vendor firms. MMI is a leader for the advisory solutions industry on regulatory and legislative issues.

As the leading industry association representing providers of managed account solutions, we are commenting on the Proposal in the context of retail managed accounts. We also agree with the comments that are being submitted by our fellow trade associations, the Investment Advisers Association, the Investment Company Institute, Securities Industry and Financial Markets Association ("SIFMA"), and the Asset Management Group of SIFMA. MMI supports and incorporates herein the advocacy of these other trade associations.

1. The Proposal's requirement that an adviser obtain written agreements and written assurances from qualified custodians would be unduly burdensome in retail managed account programs.

The Proposal does not adequately consider how investment advice is provided to clients across a spectrum of different managed account programs, many of which can involve multiple advisers that each pursue specific strategies or may perform different functions. For instance, advisers may offer manager-of-manager strategies that combine advisory services of multiple

[1] See Safeguarding Advisory Client Assets, Advisers Act Release No. 6240 (February 15, 2023), https://www.sec.gov/rules/proposed/2023/ia-6240.pdf; 88 FR 14672 (March 9, 2023), https://www.federalregister.gov/documents/2023/03/09/2023-03681/safeguarding-advisory-client-assets.

advisers responsible for sub-strategies or for specialized services such as portfolio optimization, tax loss harvesting, evaluation of wash sale issues, etc. Current retail managed account programs (also known as "wrap fee programs") are offered under various structures, including the following:

Single contract programs pursuant to which a client engages a primary adviser (often the program sponsor) that is typically also a broker-dealer (dual registrant) that custodies client assets, which curates the field of and engages other advisers that manage specific strategies, which may be offered in so-called "sleeves" of a client's account.

Dual contract programs pursuant to which the client will have a contract with a dual registrant or broker-dealer sponsor of the program or other qualified custodian (which may or may not serve as adviser) and where the client directly selects and contracts with a separate adviser, which typically does not select or contract with the broker-dealer or other qualified custodian (and which is often hired by the client to act as an intermediary between the client and the adviser).

Unified Managed Accounts (UMAs), whereby the primary adviser or dual registrant (often the program sponsor) typically offers a multi-strategy portfolio divided into sleeves that can include not just separate portfolios managed by separate advisers, but also separate sleeves consisting of mutual funds, ETFs, strategies or other assets managed in a commingled form, often with a so-called "overlay adviser" responsible for functions such as monitoring portfolio concentration, providing tax optimization advice and similar services.

Model-based programs, which can follow the structures discussed above and provide for an adviser to manage a client portfolio or sleeve of a portfolio based upon non-discretionary model portfolios provided by other third parties, which may or may not be advisers.

In all the above structures (except dual contract arrangements), there is a primary adviser that has contracted with the client and coordinates with other advisers in various respects. Many if not most of these advisers play no role in the selection or engagement of the client's qualified custodian, are not client-facing and have no contract with the qualified custodian as it pertains to the qualified custodian's provision of custodial services to clients. To the extent the Proposal would require each adviser participating in this managed account ecosystem to satisfy the requirements that an adviser enter into written agreements and receive written assurances from each qualified custodian, that would effectively shut down these programs and impede the ability of primary advisers to deliver "best-of-breed" services to their clients by tapping the specialized capabilities and services of a broad variety of other advisers.

It is important to note that these managed account programs are relatively fluid in the sense that client assets are often reallocated across different advisers, with underperforming advisers being substituted with other advisers, and the addition of new advisers to offer new strategies possibly involving new types of asset classes and possibly involving other custodians or sub-custodians in a highly dynamic process – all designed to deliver the best service to clients. If each adviser participating in these programs, up and down the chain, were required engage in negotiations with and sign written agreements and obtain written assurances from each custodian participating in the program before providing investment advice, there would be no practical way

they could do so without involving substantial disruptions in client advice. Very often, the advisers (other than the primary adviser) participating in these managed account programs concentrate on delivering their best advice but do so on relatively thin profit margins. The imposition of the significant burdens contemplated by the Proposal would effectively render advising managed accounts – especially retail managed accounts – completely unworkable and uneconomical. The Proposal fails to acknowledge, address, or justify these negative consequences, particularly for retail clients.

Any obligation to have a written agreement with and obtain written assurances from a qualified custodian under the Proposal should extend only to the primary adviser (typically the sponsor) in a managed account program. It makes little sense for other participating advisers to be subject to these requirements and obligations particularly when they are providing advice, subject to the primary adviser's supervision, on certain sub-strategies, certain overlay strategies to the extent deemed to be providing investment advice or other services provided in support of the overarching advice provided by the primary adviser.

2. ***The SEC should not require that qualified custodians send copies of periodic account statements to advisers.***

The Proposal's requirements that a qualified custodian send periodic customer account statements to each adviser – in addition to the client – based on the notion that this may help advisers reconcile custodial reports with their own information[2] does not make sense in today's managed account programs. Investment advisers participating in managed account programs have real-time electronic access to qualified custodian systems that provide advisers with information on pending and executed transactions and positions in client portfolios for them to reconcile the qualified custodian's information with their own on a contemporaneous basis. Providing advisers with quarterly reports of stale information that may be upwards of 90+ days old and any expectation that the advisers will review that stale information simply imposes superfluous burdens on advisers with no benefit in terms of protection of customer assets.

Also, periodic customer account statements provide a consolidated reporting of holdings and transactions in a client's account and are useless for advisers managing only part of the account's assets, as is the case with multi-strategy programs and UMAs for which an adviser only advises a single sleeve of client portfolios.

Moreover, receiving copies of periodic customer account statements in no way helps an adviser in forming a reasonable belief that the qualified custodian is sending these periodic customer account statements to clients – any more than a qualified custodian's giving an adviser access to its

[2] See Proposal at 14697 (stating "In a change from the current custody rule, the qualified custodian would also now be required to send account statements, at least quarterly, to the investment adviser, which would allow the adviser to more easily perform account reconciliations.").

website portal where customer account statements are posted and are available, which the SEC has long concluded does not suffice for this purpose.[3]

Most importantly, managed account programs are typically structured and operated so that the sponsor and primary adviser shares with other advisers only such information concerning enrolled clients as the other advisers reasonably need in order to perform their respective services. This information often does not include nonpublic personal information about enrolled clients for many reasons, including to ensure that client nonpublic information is properly safeguarded from data breaches and other data security issues. Customer account statements include various items of client nonpublic information (e.g., name, address, account numbers, sometime Social Security Numbers, etc.) and, in no event is this information relevant to the investment advice provided by these other advisers.

3. The Proposal does not address practical issues that will arise for adviser potentially encountering questions with qualified custodian compliance with written agreements or assurances.

The Proposal does not address important questions that will arise in practice relating to how an adviser should address situations where it has questions on whether a qualified custodian is complying with its agreement or written assurances. This includes where those questions go to matters that are potentially immaterial in an overall assessment or where addressing the questions could require back-and-forth communications with the qualified custodian, exchanges of information with them, the possible need for additional due diligence, possible need for consultation with legal counsel for all involved, possible need for negotiation of updated written assurances, etc. – all that can take considerable time. This issue is potentially magnified substantially in managed account programs with multiple advisers unless the requirement is limited to the primary adviser because each adviser might have differing views on the matter, which will further complicate and delay resolution of any questions.

In these and other circumstances, is the adviser required to resign from the affected client accounts, cease discretionary advice over those accounts (or revert to non-discretionary advice and, if so, what notice should be afforded clients) or take other actions?

Moreover, at what point after questions surface initially – in what can be a lengthy process – is an adviser going to be viewed as having not satisfied its obligation to have a "reasonable belief" that the qualified custodian is complying with its written agreement and assurances? Is this when the questions first emerge, only later once the adviser receives information that would enable the adviser to make an informed determination on the matter or somewhere in between?

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[3] See SEC, Custody of Funds or Securities of Clients by Investment Advisers, 75 Fed. Reg. 1456, 1458 & n.21 (Jan. 11, 2010) (stating that "We believe that accessing account statements through the Web site merely confirms that they are available. If an adviser does not take additional steps to determine whether account statements were sent to clients, or that clients obtained statements through the Web site, the adviser would have an inadequate basis for forming a reasonable belief, after due inquiry, that the qualified custodian sends account statements to clients.").

4. *The SEC should confirm that model providers do not have discretionary authority for purposes of the Proposal.*

The Proposal's expanded definition of "custody" to include discretionary authority, which in turn is defined as "the authority to decide which assets to purchase and sell for the client," is an unwarranted expansion of the concept of custody and potentially sweeps in many advisers in managed account programs that have only limited authority or play a more peripheral or limited role in deciding which assets to purchase and sell. Without limiting the generality of this concern, the Proposal should make it abundantly clear that an adviser providing advice in the form of model portfolios does not have discretionary authority for purposes of the Proposal's requirements despite the fact that such model providers might in certain circumstances be viewed as having investment discretion and beneficial ownership reporting obligations under the Securities Exchange Act of 1934.[4]

5. *The Proposal's redefinition of "qualified custodian" would effectively preclude use of bank deposit accounts and foreign securities in managed accounts.*

The Proposal's requirements that a qualified custodian that is a bank or savings association segregate cash "in an account designed to protect such assets from creditors of the bank in the event of the insolvency or failure of the bank" and that "account terms should identify clearly that the account is distinguishable from a general deposit account" so that client assets are protected "from creditors of the bank or savings association in the event of [its] insolvency or failure" will preclude use of yield-bearing bank accounts in managed account programs. In bank deposit accounts, cash is held as a liability of the bank and available for use by the bank in the ordinary course of its business activities, which helps the bank pay interest on the deposited cash. Cash in a deposit account is federally insured by the FDIC up to the standard maximum deposit insurance amount, currently $250,000, per depositor, per insured institution, for each account ownership category (e.g., single ownership, joint ownership, or ownership by a corporation or partnership).

Similarly, the Proposal's requirements for qualified custodians that are foreign financial institutions ("FFIs") that all assets, including cash, be held "in an account designed to protect such assets from creditors of the [FFI] in the event of [its] insolvency or failure" and that the SEC be able to enforce judgments, including civil monetary penalties, against FFIs would similarly preclude FFIs from acting as sub-custodians for foreign securities. In other words, if FFIs cannot or will not meet the requirements of the Proposal, advisers and their clients would be shut out of those foreign markets and would be unable to invest in foreign securities in overseas markets. This, in turn, would force advisers and their clients to execute foreign securities trades on their own, without the intermediation of their adviser, or instead to trade in American depository receipts ("ADRs") even when the underlying non-US securities offer more favorable terms, including price, because the markets for the underlying non-US securities are typically far more liquid than the corresponding

[4] See Securities Exchange Act Section 3(a)(35) (defining investment discretion) & Section 13(f)-(h) (governing beneficial ownership reporting).

market for ADRs. In a number of cases, it would limit the choice of investors and advisers to invest in global markets.

6. The SEC needs to rethink the timeframes needed to transition to the Proposal's requirements.

The proposed transition arrangements under the Proposal do not factor in the substantial work that both advisers and qualified custodians would have to undertake to come into alignment with the Proposal's requirements, including for many managed account program participants but particularly managed account program sponsors. This will require extensive planning (in many cases requiring the use of outside consultants); process, systems and technology changes that typically require very long lead times (e.g., lead times that include planning around code changes, code development, independent code testing prior to code being released into production); making any necessary structural changes to manage account programs; after plans have been developed, close coordination with other advisers and service providers; reviewing and revising managed account program documentation and disclosures; developing communication programs with clients, and so on.

Moreover, the Proposal's approach of looking to an adviser's assets under management to evaluate and provide for transition timing is an illogical basis when the size of an adviser in terms of assets under management does not have any bearing on the magnitude of the changes for them, the number of qualified custodians with which they deal, the extent to which they provide discretionary investment advice for assets that cannot be maintained with a qualified custodian, and the many other factors that will pose timing challenges for advisers. Finally, the Proposal gives little if any consideration under the transition provisions for the burdens faced and transition demands and timelines for qualified custodians, including those custodians which may deal with tens of thousands of advisers and millions of clients.

Ultimately, we believe that the Commission has not sufficiently evaluated or justified the need for the Proposal. We further believe that the Proposal does not represent an appropriate, clearly defined framework that reasonably can be implemented by the adviser and broader qualified custodian industry. Rather, we believe that the Proposal may expose advisers to inappropriate responsibility and liability for the conduct of qualified custodians and will lead to unreasonable costs, with small advisers and their clients feeling a disproportionate impact.

We hope that our comments are helpful to the Commission and its staff. We would be glad to answer any questions or provide further assistance. Please feel free to contact me at (646) 868-8501 or contact Chad Papanier at (646) 868-8506

Very truly yours,

Craig Pfeiffer
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