Dimensional

Dimensional Fund Advisors LP
6300 Bee Cave Rd., Building One
Austin, TX 78746

May 8, 2023

Vanessa A. Countryman
Secretary
US Securities and Exchange Commission
100 F Street NE
Washington, DC 20546-1090

Re: Safeguarding Advisory Client Assets, File No. S7-04-23

Dear Ms. Countryman,

Dimensional Fund Advisors LP ("Dimensional") appreciates the opportunity to comment on the US Securities and Exchange Commission's ("Commission") proposed rules on safeguarding advisory client assets.[1] Dimensional is a registered investment adviser and together with its advisory affiliates, has approximately $614 billion in global assets under management.[2] We are very concerned that expanding the definition of custody to include discretionary authority will be extremely costly for advisers[3] and custodians and will unnecessarily increase the costs of advisory and custodial services for investors. We strongly urge the Commission to consider the effect its proposal will have on the cost of advisory and custodial services and on the competitiveness of US-based investment advisers.

1. ***Expanding the definition of custody to include an adviser's discretionary authority will increase the cost of advisory and custodial services for investors, disproportionately affect smaller advisers, and reduce the competitiveness of US-based investment advisers.***

First and foremost, we are extremely concerned by the expansion of the definition of custody to include discretionary authority. Under the proposed rules, an adviser that has discretionary authority over a client's assets would be deemed to have custody over those assets. This would mean that if an adviser has the authority to decide which assets to purchase and sell for their client, the adviser would be required to comply with the proposed rules for these accounts, even if the adviser does not hold client assets or have authority to obtain possession of them. We believe this is an unnecessary expansion of the meaning of the term custody. Imposing the proposed safeguarding rule in a situation where a client has opened an account and then authorized their adviser to direct trades within this account is a curious—and costly—result. We cannot overemphasize what a significant impact this will have on existing industry practices. Under the current custody framework, it is very common for advisers to have discretionary authority—but not custody—over their clients' accounts. If the definition of custody is expanded to include

[1] US Securities and Exchange Commission, *Safeguarding Advisory Client Assets*, Release No. IA-6240 (Feb. 15, 2023) (the "Proposal").

[2] As of March 31, 2023.

[3] Throughout this letter, the term "adviser" refers to investment advisers that are registered with the Commission and would be subject to the proposed rules.

discretionary authority, it will drastically increase the number of accounts over which advisers will be deemed to have custody, leading to increased costs and burdens for advisers and custodians, which are likely to be passed on to investors in the form of increased advisory fees and custodial fees.

Under the proposed rules, advisers will be required to enter into written agreements with each of their discretionary clients' custodians, which, as the Commission acknowledges, would be a substantial departure from current industry practice.[4] Under the current custody framework, custody matters are typically handled directly between investors and their custodians—advisers have no need to be privy to these negotiations if they have discretion, but not custody, over their clients' assets. Particularly in the case of institutional investors, it is the investor that selects the custodian and negotiates the terms of the custodial agreement. Generally, the investor's investment adviser is not consulted on the terms of the custodial agreement, does not negotiate with the custodian on behalf of the investor, and is not a party to the custodial agreement. The proposed rules would force advisers to insert themselves into these historically bilateral negotiations, even though they are neither the investor nor the service provider under the agreement. Advisers would also not be paying nor receiving a fee under the custodial agreement, leaving them without bargaining power to force custodians to agree to the terms that would be required by the Commission's rules.

Furthermore, as a result of the expansion of the definition of custody and the limited utility of the discretionary authority exception (discussed below in Section 3), more advisers will be required to engage independent public accountants to conduct annual surprise examinations to verify client assets. Under the current custody rules, Dimensional has not been required to engage an auditor to conduct surprise examinations, but we understand these examinations to be tremendously expensive.

If the scope of the rule is expanded, implementing these aspects of the proposed rules will cost advisers time and money, and will distract advisers' attention away from their primary role—providing investment advice. Investors are likely to end up paying more for advisory and custodial services, despite not receiving a commensurate increase in the level of services rendered. In general, we note that the proposed rules will disproportionately affect smaller investment advisers and their retail clients. Smaller advisers may not be able or willing to absorb the costs of negotiating written agreements with each of their clients' custodians or the costs of engaging independent public accountants to conduct surprise examinations. This is likely to result in an increase in the price of investment advice for retail investors. Investors might also see a decrease in services if advisers, particularly smaller ones, must divert time and resources away from client servicing activities to comply with the new safeguarding rule. Some advisers may even choose to change the services they currently provide—for example, by offering non-discretionary rather than discretionary advice—if it means they can avoid triggering the application of the rule. Further, if advisers determine it is operationally more efficient to work with only a limited number of custodians, or if custodians are unwilling to agree to the terms required by the proposed rules, then investors would have fewer custodians to choose from. All of these potential consequences would negatively impact the availability of independent financial advice to retail investors. In our

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4 Proposal at 77.

experience, retail investors benefit greatly from independent financial advice. Advisers provide a range of wealth management services and can help retail investors to understand their financial needs while encouraging the discipline essential to long-term investment success. We believe it is a mistake to make it more difficult for retail investors to engage the services of a registered investment adviser, and we are concerned that the proposed rules would have this effect by imposing unnecessary, costly, and distracting burdens on advisers.

Finally, the proposed rules are likely to reduce the international competitiveness of US-based investment advisers. Foreign investors, such as foreign sovereign wealth funds, may be unwilling to have their accounts subject to a surprise examination, and so the expansion of the rule may deter them from selecting a US-based investment adviser. Foreign custodians may also be unwilling to agree provisions required by US laws in a written agreement between the adviser and custodian, which would further discourage foreign investors from selecting US-based investment advisers. We are extremely concerned that the costs and burdens associated with the proposed safeguarding rule will put US-based investment advisers at a significant competitive disadvantage compared to foreign advisers.

For these reasons, we strongly believe that the Commission should not expand the definition of custody to include discretionary authority.

2. If the Commission expands the definition of custody to include discretion, the rule should provide a full exemption for certain types of clients.

If the Commission determines that it must expand the definition of custody to include discretion, we strongly urge the Commission to tailor its approach much more narrowly. Advisers have discretionary authority over many types of accounts, including some that are already subject to rules and oversight mechanisms that are designed to protect against the risk that client assets will be lost, misused, stolen, or misappropriated. For these types of client accounts, the Commission should consider whether subjecting them to the proposed safeguarding rule would produce any additional benefits that would justify the costs to advisers of complying with the rule.

For example, under the proposed rules, if a US-based registered investment adviser acts as a sub-adviser to and has discretionary authority over a UCITS[5] fund domiciled in Ireland, such an adviser would be deemed to have custody and would be required to comply with the safeguarding rule with respect to this Irish UCITS fund. In our view, this would be wholly unnecessary—the European Union's UCITS regulatory framework already provides extensive safeguarding protections for UCITS investors. Under the EU framework, a UCITS fund must appoint a depositary to perform safe-keeping functions for the fund and comply with detailed provisions regarding the custody of portfolio assets.[6] Similarly, in the US, advisers to bank-maintained collective investment trusts ("CITs") typically have discretionary authority over the CIT's assets,

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5 UCITS stands for Undertakings for Collective Investment in Transferable Securities.

6 *See* Directive 2009/65/EC of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, 2009 O.J. (L 302/32).

which would constitute custody under the proposed rules. We believe it would be unnecessary to require advisers to comply with the Commission's proposed safeguarding rule with respect to CITs when federal banking regulations already require that the bank administering the CIT act as a fiduciary and hold legal title to the trust's assets.

In these cases, the costs of complying with the proposed rules will almost certainly outweigh the benefits to investors, since these products already have safeguarding mechanisms in place. UCITS and CITs are merely two examples of such types of products, and we strongly encourage the Commission to identify and examine the many different types of accounts that will be in scope of the Commission's safeguarding rule but that are already subject to rules and/or mechanisms designed to protect against the risk of misappropriation. The Commission should carefully consider whether subjecting these accounts to the proposed safeguarding rule would produce additional benefits to investors that would justify the costs to advisers of complying with the rule.

3. If the Commission expands the definition of custody to include discretion, the corresponding exception from the surprise examination requirement should not be limited to cases where the adviser only has discretion over assets that settle exclusively on a delivery versus payment basis.

If the Commission determines that it must expand the definition of custody to include discretion, we also strongly urge the Commission to expand the availability of the proposed exception from the surprise examination requirement. Under the proposed rules, if discretionary authority is the sole basis for custody, an adviser will not be required to engage an independent public accountant to conduct an annual surprise examination to verify client assets independently, but only if the adviser's discretion is limited to instructing the client's qualified custodian to transact in assets that settle exclusively on a delivery versus payment ("DVP") basis. As noted above, we understand surprise examinations to be extremely costly, and we appreciate that the proposal seeks to balance the costs associated with the surprise examination requirement by including this exception. However, in practice, the proposed exception will be of limited utility for many advisers. Advisers are commonly authorized to trade securities for their clients do not settle exclusively on a DVP basis—for example, equity securities in many commonly traded foreign markets do not settle DVP. As a result, many advisers will have to choose between not investing their clients' accounts in securities that do not settle DVP—which would deprive their clients of the ability to invest in certain markets or types of securities—or bearing the cost of surprise examinations. We strongly encourage the Commission to remove this limitation from the exception altogether. If an adviser's sole basis for custody is discretion, the adviser should not be required to undergo a surprise examination, regardless of the settlement mechanism of the securities that the adviser is authorized to trade.

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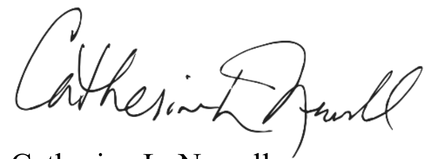
For these reasons, we strongly urge the Commission not to expand the definition of custody to include discretionary authority. Doing so would significantly increase the costs of advisory and custodial services for investors, disproportionately affect smaller advisers, and reduce the

competitiveness of US-based investment advisers. If we can be of further assistance, please do not hesitate to contact Stephanie Hui, Lead Counsel, Global Public Policy and Vice President. We would welcome the opportunity to expand on our discussion of these issues.

Sincerely,



Catherine L. Newell
General Counsel and Executive Vice President