

Via E-mail (rule-comments@sec.gov)

May 8, 2023

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Safeguarding Advisory Client Assets (Release No. IA-6240; File No. S7-04-23; Fed. Reg. No. 2023-03681)

Ms. Countryman:

Apogem Capital LLC (“Apogem”) submits this letter in response to the request for comments by the Securities and Exchange Commission (the “SEC” or the “Commission”) with respect to its proposal to amend and replace Rule 206(4)-2 (the “Custody Rule”) under the Investment Advisers Act of 1940, as amended (the “Advisers Act”) with Rule 223-1 (the “Proposed Rule”).¹

Apogem is an alternatives investor, with decades of experience investing in the middle market.² Apogem is an investment adviser registered with the SEC that invests certain of its advisory clients’ assets in senior loans made to middle market companies, as well as related mezzanine debt and equity investments. Apogem also has a substantial loan syndication business in which Apogem and its affiliates, as well as third-party institutional investors, are loan syndicate participants. Since 2018, Apogem has relied on no-action relief from the staff of the SEC’s Division of Investment Management (the “2018 No-Action Letter”) permitting Apogem to perform administrative agent services for its loan syndication business where it does not comply with provisions (a)(1) and (a)(3) of the Custody Rule.³

Apogem appreciates the opportunity to highlight its concerns about the effect of the Proposed Rule on Apogem’s loan syndication business. As discussed below, the segregation requirement in the Proposed Rule would fundamentally disrupt Apogem’s loan syndication business in a manner that would be extremely costly and time-consuming to address. To comply with the Proposed Rule,

¹ See Safeguarding Advisory Client Assets, Release No. IA-6240, 88 FR 14672 (Mar. 9, 2023) (the “Release”).

² As of December 31, 2022, Apogem managed approximately \$38.7 billion of regulatory assets on a discretionary basis and approximately \$1.5 billion on a non-discretionary basis.

³ Madison Capital Funding LLC, SEC No-Action Letter (Dec. 20, 2018). Apogem was previously known as New York Life Investments Alternatives LLC and primarily operated its advisory activities through three relying advisers, GoldPoint Partners LLC (founded in 1999), Madison Capital Funding LLC (“Madison”) (founded in 2001) and PA Capital LLC (founded in 1997). On April 1, 2022, these three relying advisers were combined into Apogem. References in this letter to Apogem prior to April 1, 2022 include Madison.

Apogem would need to develop an entirely new business model and renegotiate the terms of existing loans to establish new arrangements for loan servicing, with negative effects on the availability of the asset class for investors and the benefits derived from Apogem serving as the administrative agent. The protections established in the 2018 No-Action Letter, however, have proven effective in safeguarding client assets from the risks animating the Proposed Rule. We request therefore that the Commission preserve the relief given in the 2018 No-Action Letter as part of the adoption of any final rule by codifying an exception directly into the rule text or alternatively, by incorporating an exception in interpretive guidance in the adopting release to Rule 223-1.

Background

Apogem's Loan Syndication Business

As the successor to Madison, Apogem is a non-bank lender providing senior loans to middle market companies. For a majority of such senior loans, Apogem organizes a loan syndicate (a "Loan Syndicate") and serves as the administrative agent to the Loan Syndicate. The participants in a Loan Syndicate (the "Loan Syndicate Participants") generally include Madison, an affiliate of Apogem, other affiliates of Apogem, other bank and non-bank lenders, and various institutional and sophisticated investors (either directly, through self-directed investments or separately managed accounts, or through private investment vehicles in which they invest).

As the administrative agent to the Loan Syndicates, Apogem performs the duties and responsibilities typically assigned to an administrative agent for and on behalf of each Loan Syndicate. The administrative agent has a significant role in the relationship between the Loan Syndicate and the borrower, which includes the primary functions of: (i) serving as a conduit for most communications (whether ministerial or material) between the borrower and the Loan Syndicate; (ii) being the single point of contact for payment of principal and interest, as well as the receipt of loan proceeds, so that the borrower does not need to make or receive multiple wires; and (iii) allowing loans to be traded among lenders without disrupting the relationship with the borrower.

Like the credit agreements for most syndicated loans, each Loan Syndicate's credit agreement requires Apogem to follow negotiated guidelines or formulas regarding the movement of cash to and from the lenders and the borrower, as applicable, for the Loan Syndicate (*e.g.*, the collection of loan proceeds from lenders and their disbursement to the borrower, as well as the use and distribution of payments received from the borrower). Accordingly, Apogem, in its capacity as the administrative agent, applies the terms of each credit agreement and has no independent authority to determine how the cash is used, allocated or disbursed.

A single bank account (the "Agency Account"), established by Apogem and maintained by a major U.S. bank that meets the definition of a "qualified custodian" under the Custody Rule and would meet the definition of that term under the Proposed Rule, facilitates the movement of cash to and from the lenders and the borrowers, as applicable, for all of the Loan Syndicates. The Agency Account is opened by and maintained in the name of Apogem as agent for the Loan Syndicate Participants (*i.e.*, the funds related to the Loan Syndicates are not held in separate accounts or sub-accounts for each Loan Syndicate Participant under the Loan Syndicate Participant's name but are

commingled in the Agency Account). The qualified custodian of the Agency Account does not send Agency Account statements to the Loan Syndicate Participants.

Apogem's Investment Advisory Business

In addition to its business as a middle market lender, loan syndicator and administrative agent, Apogem provides investment advisory services to private investment funds and separately managed accounts for institutional investors (collectively, "Advisory Clients"). Apogem invests certain of such Advisory Clients' assets in senior loans made to middle market companies, as well as related mezzanine debt and equity investments. The senior loans held in such Advisory Clients' portfolios are generally loans that were originated by Apogem; for a majority of such senior loans, Apogem organized the Loan Syndicate and serves as the administrative agent to the Loan Syndicate.⁴ Loan Syndicate Participants therefore may include Advisory Clients and other sophisticated investors that are not Advisory Clients, including one or more affiliates of Apogem (collectively, "Non-Client Participants").⁵ Each Advisory Client has established a separate account at a qualified custodian where such Advisory Client's portfolio holdings and cash, including its interest in any Loan Syndicate and its share of the interest and principal payments from the Agency Account, are held, which is maintained by a major U.S. bank that meets the definition of a qualified custodian. For each Advisory Client, either: (i) the qualified custodian of such Advisory Client's bank account sends quarterly account statements to the Advisory Client; or (ii) such Advisory Client is a pooled investment vehicle that prepares and distributes audited financial statements in accordance with the Custody Rule.

2018 No-Action Letter

In the 2018 No-Action Letter, the staff took a no-action position under the Custody Rule based on the facts described above if Apogem acts as an administrative agent to Loan Syndicates with custody of the Agency Account used to facilitate payments between borrowers and lenders. The staff's position was subject to eleven conditions, as set out in the 2018 No-Action Letter and included as Appendix A to this letter. Apogem has relied on the 2018 No-Action Letter since its issuance and understands that other investment advisers with comparable lines of business have relied on the 2018 No-Action Letter.

The Proposed Rule Would Fundamentally Disrupt Apogem's Loan Syndication Business

Apogem is concerned that its loan syndication business would not comply with the segregation requirements in the Proposed Rule. The Proposed Rule, in relevant part, would require that client assets over which an adviser has custody not be commingled with the assets of the *adviser or its*

⁴ Advisory Clients may also be part of loan syndicates organized by unrelated third parties.

⁵ Madison or another affiliate of Apogem is often, if not almost always, a Loan Syndicate Participant, and for purposes of this letter, it is not treated any differently from any other Loan Syndicate Participant. It is commonplace, and expected, for nonbank lenders or their affiliates to participate as lenders in the loan syndicates for which they also serve as administrative agent. In addition, for purposes of this letter, a Loan Syndicate Participant includes Advisory Clients or Non-Client Participants, that acquire a portion of the Loan Syndicate, through transfer or otherwise, after the loan proceeds are distributed to the borrower.

*related persons.*⁶ The Release states that the proposed segregation requirement is designed to prevent misuse or appropriation of client assets and help ensure that client assets are isolated and more readily identifiable as client property.⁷ It is this aspect of the Proposed Rule that would pose a significant challenge for Apogem's loan syndication business because the Loan Syndicate Participants regularly include Apogem and its related persons.⁸

The segregation requirement in Proposed Rule would fundamentally disrupt Apogem's loan syndication business in a manner that would be extremely costly and time-consuming to address. If the proposed segregation requirement is adopted, Apogem would be required to develop an entirely new business model that eliminates any commingling of client assets with those of Apogem and its related persons in the Agency Account. Apogem also would need to renegotiate the terms of existing loans to establish new arrangements for loan servicing. If feasible at all, such a reconfiguration of the loan syndication business could negatively affect the availability of an attractive and growing asset class to Advisory Clients and would reduce the benefits described below that Advisory Clients receive from having Apogem serve as the administrative agent.

The Protections of the 2018 No-Action Letter Are Sufficient to Protect Client Assets

The Release indicates that the staff is reviewing existing no-action letters, including the 2018 No-Action Letter.⁹ Apogem requests that the Commission preserve the relief given in the 2018 No-Action Letter as part of the adoption of any final rule by codifying an exception directly into the rule text or alternatively, by incorporating an exception in interpretive guidance in the adopting release to Rule 223-1.¹⁰ Apogem proposes to continue to comply with the conditions of the 2018 No-Action Letter.

A number of reasons support preserving the established practices of Apogem's loan syndication business under any final version of the Proposed Rule. First, the Release recognizes that commingling assets in an Agency Account serves the client goal of efficient administration of investments.¹¹ Without an administrative agent, borrowers would need to interact with multiple lenders, risk making payments to the wrong lender (or to the correct lender but for the wrong

⁶ Proposed Rule 223-1(a)(3)(ii).

⁷ Release, at 14714.

⁸ Apogem acknowledges that the Proposed Rule provides a partial exception for arrangements in which assets are commingled with the client's consent. This exception, however, only extends to the proposed prohibition in subparagraph (iii) against subjecting client assets to any right, charge, security interest, lien, or claim in favor of the investment adviser, its related persons or creditors. See Proposed Rule 223-1(a)(3)(iii). It would not address subparagraph (ii), which is the subject of this letter.

⁹ Release, at 14732

¹⁰ In the event that the Commission does not preserve the relief in the 2018 No-Action Letter and the staff determines to rescind the 2018 No-Action Letter, Apogem requests that the staff permit Apogem to continue to rely on the 2018 No-Action Letter until the compliance date. Apogem further requests that the Commission adopt a uniform compliance date for advisers that is at least 24 months after the effective of any final rulemaking. See id. If registrants were to seek additional no-action relief, such a process would be very time consuming and costly to obtain relief.

¹¹ See id. at 14695 ("We also understand that for administrative convenience and other reasons qualified custodians often hold client assets in omnibus accounts containing assets of more than one client or similar commingled-style accounts.").

amount) and, if a lender were to sell its loan to another lender, the borrower would need to comply with instructions from and make wire payments to that new lender – all of which would increase the burden, risk, complexity, and cost for the borrowers and the lenders. As Loan Syndicate Participants, Advisory Clients would bear these risks and costs, and it is far from clear that such sophisticated investors would receive any additional benefit from applying the proposed segregation requirement to Apogem’s loan syndication business. To the contrary, the Release indicates that the Commission does not “intend the prohibition on commingling to preclude traditional operational practices in which client assets are held together with other clients’ assets.”¹² In fact, the Release supports the continuation of established practices by which client assets are commingled with non-client assets specifically in the context of loan servicing accounts like the Agency Account.¹³

Second, private credit lenders provide an important source of capital for the U.S. economy that would be limited if the loan syndication business model must be reconfigured to comply with the Proposed Rule.¹⁴ This lending capacity is especially important at the present moment with signs of a pullback in bank lending from the fallout of recent banking crises.¹⁵ Thus, a contraction of the loan syndication business to comply with the Proposed Rule would risk broader effects on the health and soundness of the U.S. economy at a critical time.

Last and most importantly, the conditions of the 2018 No-Action Letter have proven to be effective safeguards to protect client assets from the risks associated with commingling. Under the 2018 No-Action Letter, affiliated syndicate participants are subject to the same controls, regulations and contractual provisions as third-party participants. In this regard, the Release recognizes that “some advisers and custodians regularly service assets in a manner where such assets are reasonably identifiable from other clients’ assets and not subject to increased risk of loss from adviser misuse or in the case of adviser insolvency.”¹⁶ There is no need therefore to disrupt established business practices for the sake of replacing client protections that already work.

* * *

Apogem encourages the Commission to preserve the relief that the staff provided in the 2018 No-Action Letter. Apogem believes the 2018 No-Action Letter strikes the appropriate balance between effective client protections and enabling the loan syndication business to operate to the benefit of clients and the U.S economy.

¹² Id. at 14714.

¹³ See id. at 14696 (“Eliminating the custody rule’s requirement to maintain accounts that contain only clients’ funds and securities also should alleviate certain compliance challenges when client and non-client assets are commingled for administrative convenience and efficiency purposes, such as in the context of sweep accounts, escrow accounts, and loan servicing accounts.” (citing the 2018 No-Action Letter)).

¹⁴ As of the end of Q3 2022, \$172.1 billion was raised by private debt funds globally and 527 private-debt backed deals were completed. See Preqin Global Report 2023: Private Debt (Dec. 14, 2022), at 7.

¹⁵ See, e.g., Gabriel T. Rubin, *Lending Slowed, Economy Cooled After Bank Failures, Fed Report Shows*, Wall St. J. (Apr. 19, 2023).

¹⁶ Release, at 14714.

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Respectfully submitted,



Apratim (Robby) Sen
Associate General Counsel

cc: Chairman Gary Gensler
Commissioner Hester M. Peirce
Commissioner Caroline A. Crenshaw
Commissioner Mark T. Uyeda
Commissioner Jaime Lizárraga

Appendix A

Conditions for Relief in the 2018 No-Action Letter

1. The Agency Account will be maintained with a Qualified Custodian, as defined in the Custody Rule.
2. Only the assets of Loan Syndicate Participants will be placed in the Agency Account.
3. No cash will be deposited in or withdrawn from the Agency Account except pursuant to the credit agreements for the Loan Syndicates.
4. Apogem will receive payments from Loan Syndicate Participants or underlying obligors only as agent for the Loan Syndicate Participants (and such payments would not be a part of Apogem's estate in bankruptcy).
5. In addition to disclosing on its Form ADV Part 1A the Advisory Client assets over which Apogem has custody and each qualified custodian with which such assets are maintained, Apogem will provide disclosure in its Form ADV Part 2A to reflect its custody of the assets in the Agency Account and that the account commingles Advisory Client and Non-Client Participant¹⁷ assets.
6. Apogem will develop and implement controls for its administrative agent services which include controls that are designed and implemented to ensure that: (i) the assets of the Loan Syndicate Participants are safeguarded from loss or misappropriation; (ii) the assets in the Agency Account are distributed in a timely manner, accurately and completely, and in accordance with the applicable credit agreements; and (iii) the administrative agent services are, and the Agency Account is being operated in a manner that is, consistent with the credit agreements for the relevant loans ("Control Objectives").
7. Apogem will obtain a written internal control report ("Control Attestation"), no less frequently than once each calendar year, prepared by an independent public accountant ("Accountant"):
 1. The internal control report must include an opinion of the Accountant as to whether controls have been placed in operation as of a specific date, and are suitably designed and are operating effectively during the year to meet the Control Objectives;
 2. The Accountant must verify that the assets in the Agency account are reconciled to a custodian other than Apogem or a related person; and
 3. The Accountant must be registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar

¹⁷ In the 2018 No-Action Letter, Non-Client Participants were referred to as "Third Parties".

year-end, by, the Public Company Accounting Oversight Board in accordance with its rules.

8. Apogem will promptly seek to resolve any control activity exceptions identified in the Control Attestation on the part of Apogem and/or its employees to comply with or fully implement the controls to meet the Control Objectives.
9. Apogem will include the annual Control Attestation, including any qualified opinion, as part of its books and records under Rule 204-2 under the Advisers Act.
10. If the Accountant issues a qualified opinion with respect to any Control Attestation, Apogem will promptly notify Advisory Clients that are Loan Syndicate Participants and inform them of the issue(s) that resulted in such qualified opinion and how such issue(s) will be avoided going forward.
11. Apogem will detail the controls developed and implemented to ensure that the Control Objectives are achieved, as well as the Control Attestation process, in its policies and procedures adopted, implemented, and subject to, annual review under Rule 206(4)-7 of the Advisers Act.