May 8, 2023

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

Re: Safeguarding Advisory Client Assets (File Number S7-04-23)

Dear Ms. Countryman:

On behalf of the Retirement Industry Trust Association ("RITA"), we appreciate the opportunity to comment on the Securities and Exchange Commission's ("SEC's") proposal regarding the safeguarding of advisory client assets. Consistent with the purpose of the SEC's longstanding "custody rule," which the current proposal would rename as the "safeguarding rule," RITA believes that qualified custodians should be entrusted with advisory client assets to help prevent those assets from being lost, misused, stolen, or misappropriated. ***As discussed below, however, RITA is writing to express our opposition to the proposed changes that would impose new requirements on qualified custodians in ways that fall outside of the SEC's jurisdiction.*** This is done through a backdoor by requiring most investment advisers to enter into contracts with custodians mandating substantive conditions beyond what is required by the custodian's actual regulator.

RITA is a professional trade association dedicated to the expansion of opportunities for all Americans to save and invest for retirement. Founded in 1987, our association is comprised of regulated banks, trust companies and industry-related professionals. We exist to be the leading educator and advocate for the growth and best practices of the self-directed retirement plan industry by providing resources, information, communication, and support to both our members and investors.

It is important to point out that the proposal is a massive expansion of the custody rule. The proposal expands the scope of the longstanding custody rule to cover the custody of assets that the SEC does not have the authority to regulate, such as real estate, other physical assets (e.g., precious metals), and investments that are not treated as securities. For purposes of our members, the most concerning aspects of the proposal are the new requirements for an adviser to enter into a written agreement with a custodian, and for the custodian to provide certain "assurances" and custodial protections.

The Proposed Safeguarding Rule Would Exceed the Commission's Authority

For purposes of the SEC's longstanding custody rule and its currently proposed safeguarding rule, a "qualified custodian" may be organized as: "A bank as defined in section 202(a)(2) of the Advisers Act (15 U.S.C. 80b-2(a)(2)) or a savings association as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1))."[1] Many of RITA's members are entities that fall within this definition, for example because they are trust companies that qualify as "banks" under the Advisers Act, and serve as qualified custodians under the SEC's existing custody rule. Our members also meet the requirements to serve as trustees or custodians of IRA assets under Internal Revenue Code section 408(m). Importantly, these entities are subject to the jurisdiction of state and/or federal banking regulators, and with regard to the substantive regulation of their custodial services, are not subject to the jurisdiction of the SEC.[2]

Through the SEC's proposal, however, the SEC is attempting to exercise substantive authority over the custodial services offered by these banks and savings associations by requiring them to enter into written agreements with, and to provide certain assurances to, advisers when the proposal calls for the use of a qualified custodian. Most notably, through the proposal's new written agreement requirement, custodians would be contractually obligated to **annually obtain a written internal control report** that includes an opinion of an independent public accountant regarding the adequacy of the qualified custodian's controls. Moreover, the proposal would require qualified custodians to contractually agree to: (i) provide records to the SEC or an independent public accountant for purposes of complying with the rule; and (ii) send quarterly account statements to clients.

Through the proposal's written assurances requirement, banks and savings associations would be required to provide advisers with written assurance that they will **indemnify** clients (and **have insurance arrangements in place "that will adequately protect the client"**) against losses caused by a qualified custodian's negligence, recklessness, or willful misconduct. Additionally, qualified custodians would be required to provide assurances that: (i) the qualified custodian will exercise due care and implement appropriate measures to safeguard client assets; (ii) the existence of any sub-custodial, securities depository, or other similar arrangements will not excuse any of the qualified custodian's obligations to the client; (iii) the qualified custodian will clearly identify the client's assets as such, hold them in a custodial account, and will segregate all client assets from the qualified custodian's proprietary assets and liabilities; and (iv) the qualified custodian will not subject client assets to any right, charge, security interest, lien, or claim in

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[1] 17 C.F.R. § 275.223-1(d)(10)(i) (proposed).

[2] The SEC's proposal requests comments on whether its rule should permit *only* banks or savings associations that are subject to Federal regulation and supervision to act as qualified custodians; and alternatively, whether its rule should permit *only* state banks and savings associations that are members of the Federal Reserve System to act as qualified custodians. 88 Fed. Reg. 14672, 14685 (Mar. 9, 2023). RITA believes that the current criteria for the institutions that can serve as qualified custodians works well, and believes that such changes are beyond the scope of this proposal. To the extent that the SEC is seriously considering any such change, we would welcome the opportunity to meet with SEC staff to discuss the robust controls and regulations that are in place for state-regulated institutions that are currently covered by the rule. Furthermore, because the text of the regulations actually proposed by the SEC does not envision any such change, the SEC would need to issue a separate proposal to receive sufficient public input before making these changes.

favor of the qualified custodian or its related persons or creditors, except to the extent agreed to or authorized in writing by the client.

The proposal describes these as "assurances" that are given from the custodian to the adviser. In the real world, we fear these will end up being contractual conditions that advisers will impose on custodians. Even worse, many of these assurances are concerningly vague, including a requirement to have insurance "that will adequately protect the client"; to "exercise due care" and implement "appropriate" measures; and to "clearly" identify client assets.

Although RITA agrees with the longstanding view of the SEC that qualified custodians should play a "gatekeeper" function with respect to advisory client assets, we are very concerned that, through the proposed rule, the SEC would be **substantively regulating** the custodial services that are offered by banks and savings associations (which, as we note below, the SEC acknowledges "operate under regular government oversight") in ways that exceed the SEC's regulatory authority. Each of these new contractual obligations and written assurances address matters – already overseen by bank regulators – that are central to the services that are provided by banks and savings associations that serve as qualified custodians. Accordingly, the SEC does not have the authority to regulate qualified custodians in this way.[3]

Consider, for example, a state-regulated bank that provides custodial services for client assets that are not securities – e.g., cash, precious metals, and real estate. According to the proposal, if an investment adviser has discretion over those client assets, the custodian must comply with all of the contractual obligations and written assurances that would be imposed by the SEC's proposal. RITA does not believe that the SEC has the ability to use its authority to regulate investment advisers to indirectly regulate the general relationships that banks and savings associations have with their clients, as the proposal would do.

Existing State and Federal Regulation Adequately Protects Advisory Client Assets

As the SEC's proposal expressly recognizes, the entities that may serve as qualified custodians, including banks and savings associations, "operate under regular government oversight" and "are subjected to periodic inspection and examination."[4] In the case of banks and savings associations, this existing oversight specifically occurs through state and federal banking laws that are overseen by state banking regulators and the Office of the Comptroller of the Currency ("OCC").

These existing banking rules already prescribe appropriate controls and other protections for clients whose assets are held in custody. Furthermore, these banking regulators, who have decades of experience considering the issues that are relevant to banks and savings associations, are in the best position to determine the substantive conditions that should apply when these entities custody client assets. In this regard, we are concerned that the SEC's effort to set

[3] While Congress granted the SEC the authority to request and examine custodian records, it did not authorize the SEC to broadly regulate custodians in the ways contemplated in the proposal. *See* 15 U.S.C. § 80b-4(e).

[4] 88 Fed. Reg. at 14682.

minimum standards for banks and savings associations that serve as qualified custodians will effectively supersede any existing standards that have already been put in place by these other regulators after carefully considering the relevant issues and making calculated policy judgments that are specific to these regulated entities.

For example, state and federal banking regulators have their own rules addressing how assets must be held on behalf of custodial clients and how disputes with custodial clients must be resolved. Under the SEC's proposal, however, in order for a bank or savings association to serve as a qualified custodian, the bank or savings association would be required to provide reasonable assurances in writing that the "qualified custodian will indemnify the client (and will have insurance arrangements in place that will adequately protect the client) against the risk of loss of the client's assets maintained with the qualified custodian in the event of the qualified custodian's own negligence, recklessness, or willful misconduct."[5] RITA is especially concerned with this proposed requirement because it is inconsistent with state and federal banking rules that reflect calculated policy decisions that do not require banks and savings associations to provide this level of indemnification to custodial clients.

Put another way, the SEC cites no systematic failure or shortcoming of the U.S. federal or state regulatory system that oversees banks and savings associations that the SEC alone can remedy; to the contrary, our system is the envy of the world in terms of its ability to ensure client assets are safeguarded. Without pointing to any particular issue with U.S. regulators of qualified custodians, it simply is not appropriate for the SEC to impose its own set of requirements on qualified custodians indirectly through a mandate on investment advisers.

<u>The Proposal Will Unnecessarily Make Custodial Services More Expensive</u>

In addition to our jurisdictional concerns, RITA also opposes the proposal's written agreement and written assurance requirements for qualified custodians because of the disruption and costs that these new requirements will create for qualified custodians and their clients. As noted in the preceding paragraph, for example, the proposal would increase the costs for custodial services provided by a qualified custodian because every qualified custodian would need to amend their existing agreements and also factor increased liability into their pricing models.

As another example, according to the proposal, every qualified custodian would newly be required to obtain a written internal control report that includes an opinion of an independent public accountant regarding the adequacy of the qualified custodian's controls. While some qualified custodians currently obtain these reports on a regular basis, we understand that others do not currently obtain these reports. Accordingly, RITA is concerned with how the proposed safeguarding rule will make it more expensive for banks and savings associations to provide custodial services. According to the SEC's own economic analysis, these reports "could pose a substantial financial burden and time commitment" and would cost approximately $750,000 per year.[6]

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[5] 17 C.F.R § 275.223-1(a)(1)(ii)(B) (proposed).

[6] 88 Fed. Reg. at 14749-14750.

New Contractual Obligations Exceed the Commission's Authority

RITA is also concerned about the new contractual obligations that the proposal would impose on qualified custodians in apparent violation of the legal principles announced in the Supreme Court's decision in *Alexander v. Sandoval.*[7] In that case, the Supreme Court ruled that "private rights of action to enforce federal law must be created by Congress."[8] Subsequent courts, including the 2018 Fifth Circuit decision invalidating the Department of Labor's Best Interest Contract Exemption, have reaffirmed this principle. For example, the Fifth Circuit's decision ruled that "[o]nly Congress may create privately enforceable rights, and agencies are empowered only to enforce the rights Congress creates."[9]

Thus, even assuming for the sake of argument that the relevant securities statutes authorize the SEC to regulate the custodial services that banks and savings associations offer to their clients, the SEC would still not be permitted to create a new private right of action – i.e., a breach of contract claim – for advisers to enforce these standards on the SEC's behalf. While our concerns about this impermissible creation of a private cause of action clearly extend to the new written agreement requirements, which the proposal interchangeably refers to as "contractual agreements," we also have very similar concerns with the new written assurance requirements.

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Sincerely,

Mary L. Mohr
Executive Director
The Retirement Industry Trust Association

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[7] 532 U.S. 275 (2001).

[8] *Id*. at 286.

[9] *Chamber of Com. of U.S. of Am. v. U.S. Dept. of Lab.*, 885 F.3d 360, 384 (5th Cir. 2018).