May 8, 2023

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

Re: Proposed Rule: Safeguarding Advisory Client Assets (Release No. IA-6240; File No. S7-04-23)

Dear Ms. Countryman:

On behalf of our 431,000 members, the American Institute of CPAs (AICPA) appreciates the opportunity to comment on File No. S7-04-23, Safeguarding Advisory Client Assets as proposed by the Security and Exchange Commission (SEC) on February 15, 2023. In the 14 years since the last update to the investment adviser custody rule, the marketplace has changed. We commend the SEC for your efforts to protect investors. We are generally in agreement that safeguarding investor assets, and opening present custody rules to review for modernization, is a timely priority for the SEC. As you work through this rulemaking, we have some concerns to share, and we offer the following observations:

1. <u>More time needed for implementation:</u> The proposed rule provides one year after the effective date for advisers with over $1 billion in regulatory assets under management (RAUM) and 18 months transition after the final rules' effective date for advisers with up to $1 billion in RAUM to come into compliance with the rule. The short timetable proposed for implementation leaves an inadequate window to adapt practices, processes, and any related systems to ensure accounting firms, whether the firm is providing Registered Investment Adviser (RIA) services, or providing audit and attest services, to have the necessary time to adhere to any final rule changes. The timetable in the proposed rule may be beyond the ability of firms, especially small firms (defined as 50 or fewer employees), to implement new requirements in an efficacious manner and we encourage a longer transition period be considered in any final rule.

2. <u>SEC authority to regulate certain affected entities</u>: We agree with the SEC's concern that the proposed expanded availability of the audit provision may result in a limited pool of accountants eligible to provide the auditing services, which may increase costs to investment advisers and investors. Additionally, we are concerned that the Commission may risk exceeding its statutory authority in extending the safeguarding rule to 529 plans. Our principal concerns in this regard are set out below:

a. *Background*. In general, the Commission does not regulate the offer and sale of municipal securities,[1] except to the extent of retaining some power to enforce the antifraud provisions of the federal securities laws.[2] Among the types of municipal securities are unit interests in so-called "529 plans," which are offered by state governments to encourage individuals to save for future educational expenses.[3] As stated in a 2012 Commission no-action letter, 529 programs involve a state's contracting with an RIA to act as the program manager for a 529 plan trust. The program manager, in turn, contracts with a qualified custodian to maintain custody of the plan assets. Although the Commission has exercised its antifraud authority to bring Section 17 charges in connection with 529 plan offerings,[4] the Office of Chief Counsel of the Commission's Division of Investment Management took the position in the above 2012 no-action letter that 529 plans could be considered "pooled investment vehicles" for purposes of, and therefore would not be directly subject to, the Custody Rule, 17 C.F.R. § 275.206(4)-2.[5] Through this no-action letter, the position appears to have been taken that the Commission could extend its jurisdiction over 529 plan interests themselves.
b. *Current Proposal.* The effect of the proposed safeguarding rule on 529 plans would codify that outcome in regulation—i.e., extending Commission jurisdiction over fundamental aspects over the functions of certain municipal securities issuers by application of the safeguarding rule obligations onto 529 plans and similar municipal securities issuers. In doing so, the proposal seems to raise a fundamental question as to whether the Commission by adopting the safeguarding provision for RIAs would indirectly regulate 529 plan municipal securities issuers in a manner that exceeds its statutory authority. We encourage the Commission to consider whether the extension of the safeguarding rule to 529 plans is contrary to its statutory relationship with this category of municipal securities issuers.

We further believe that CPA firms are sufficiently equipped with the expertise and the experience to perform audit and attestation engagements under the existing custody rule. We are concerned that certain accounting firms would be forced to resign from their current engagements or even shut down their business as they are not PCAOB-registered and inspected. Even if these firms register with the PCAOB, they will be unable to perform the work under the proposed rule, most notably, the audits of 529 plans and ABLE plans and other entities, if they do not also audit issuers or SEC-

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[1] *See, e.g.*, Section 3 of the Securities Act, 15 U.S.C. § 77c(a)(2),
[2] *See* 15 U.S.C. § 77q(c) (nullifying the Securities Act Section 3 exemptions in the case of Section 17 violations).
[3] *See* Investor's Guide to 529 Savings Plans, https://www.msrb.org/sites/default/files/MSRB-529-Investor-Guide.pdf.
[4] *See Utah Educ. Savings Plan Trust*, Rel. No. 33-8601 (Aug. 4, 2005).
[5] 17 C.F.R. § 275.206(4)-2*See* Office of Chief Counsel, Division of Investment Management, No-Action Letter to Investment Company Institute, Ref. No. 2012961030 (Sep. 5, 2012), https://www.sec.gov/divisions/investment/noaction/2012/ici090512.htm.

registered broker-dealers that subject them to inspection. Moreover, the SEC acknowledges that the PCAOB will not inspect audits of private funds or other entities under the proposal, as the PCAOB has no authority over these audits.

It is the AICPA's position that CPA professionals are singularly competent and capable of performing engagements required in this proposal with the integrity and competence required and expected, without being PCAOB-registered. Further, the performance of audits and attest examinations is subject to AICPA peer review requirements. We do not believe there is an argument to be made that otherwise licensed and trained CPAs cannot perform engagements as required in this proposal with competence without the additional oversight of PCAOB. The incremental cost of a PCAOB-registered auditor, as well as the potential scarcity of finding such an auditor in certain communities of the United States, leads us to submit that such a requirement would be unduly burdensome and costly to many advisers, without benefit to the public or the SEC.

3. Disproportionate impact on small CPA firms that provide RIA services. The proposed rule could have a disproportionate impact on small firms that have little or no ability to implement these sweeping proposed changes – especially as they relate to a RIA's need to take on additional roles to ensure compliance with the rule, and enhanced clarity for the client funds over which they have custody. Furthermore, the significant volume of proposed RIA rulemaking this past 18 months may put smaller firms in a position to either merge with a larger firm with full-time compliance staff or, unfortunately, shut their doors. Small firms play a crucial role in maintaining a dynamic and stable marketplace that serves consumers' various needs, just as they do in other professional service industries such as law, medicine, and accounting. They provide access to a segment of the United States marketplace that may not otherwise have access to trusted investment advice and therefore serve a population that cannot afford to make a misstep while trying to navigate the complex investment market without guidance.

4. Current safeguards are adequate: CPAs that are registered as investment advisers are already subject to extensive regulations that require them to take reasonable steps to safeguard client assets, and these regulations have proven to be effective in preventing theft or misappropriation of client funds. Only a small fraction[6] of registered investment advisers has ever experienced a significant client asset loss due to fraud or theft. Additionally, custodians are highly regulated entities and advisory firms must be able to rely on the regulatory effectiveness of those regulators. We request that a thorough study be completed on the cost and overall impact of this rulemaking, namely on small firms, before the new rule is made final, as well as the anticipated benefits of implementing the new rule.

[6] Dimmock, Stephen G.; Farizo, Joseph D.; and Gerken, William C., "Misconduct and Fraud by Investment Managers" (2018). *Finance & Quantitative Methods Research Data*. https://doi.org/10.13023/nsjd-rk62

5. Additional burden on CPA firms that provide audit and attest services: The increased number and scope of audit and attestation engagements under the proposed safeguarding rule would put undue resource pressure on the accounting firms which are fully capable and already performing these audit services. Further, it will negatively impact smaller accounting firms that are otherwise qualified to perform these engagements. The added burden on these CPA firms should be considered as you further consider a final rule.

6. Expanded requirements may not prevent fraud or theft: The proposed rule would impose expanded requirements, including additional asset categories that might result in more frequent use of the annual surprise examination of client assets by an independent public accountant. Such annual surprise examinations may not in and of themselves effectively protect clients from fraud or theft and could impose a significant burden on small firms.

7. One Business Day Verification Requirement: The proposed rule would require the adviser, in accordance with a written agreement between the adviser and its independent public accountant, to notify the independent public accountant to perform a verification of any purchase, sale or other transfer of beneficial ownership of such assets within one business day of such transaction. Upon receiving this notice of the activity from the adviser, the independent public accountant would be required to verify such transaction promptly and notify the SEC within one business day of finding any material discrepancies during the course of performing its procedures. While such an engagement could be performed in accordance with the AICPA attestation standards or as part of the audit under the AICPA auditing standards, we are concerned that the timeline offered in the proposed rule is not practical and we request the SEC to more appropriately define the timeline to include such time as is needed to allow for thorough consideration by the independent public accountant. Moreover, we question whether this almost real-time examination of each transaction by the independent public accountant is needed. We believe the current procedures performed by the independent public accountant as part of the surprise examination or an audit apply to the whole population of client assets and adequately satisfy the objectives of the custody rule without the need to verify each individual transaction. We are also concerned about the accounting staff's availability, additional resources, and costs of performing the prompt verification of each transaction by a CPA firm. We doubt the benefits of this requirement outweigh its costs.

We also have the following responses to specific questions related to the proposed verification requirement:

In response to question 151[7]: Rather than requiring verification by an accountant promptly after each transfer, as proposed, we ask the SEC to allow the verification to be performed as part of the annual surprise examination or annual audit.

In response to question 160[8]: In an audit performed in accordance with auditing standards generally accepted in the United States, the auditor selects a sample that is intended to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected. An auditor would not be expected to examine each transaction during the period under the audit, and verification of all client assets not maintained with a qualified custodian would not necessarily reduce the risk of theft, loss, or misappropriation of client assets. We recommend the verification requirement permit sampling of client accounts, as opposed to verification of assets for all client accounts.

In response to question 144[9]: We believe the 2009 Accounting Guidance needs to be updated as it does not provide sufficient guidance for an accountant that is engaged to perform the proposed verification procedures around privately offered securities and physical assets that are not maintained with a qualified custodian.

That Guidance focuses on the surprise examination and internal control report requirements under the existing custody rule. If all client assets would be maintained by a qualified custodian, there may be additional control objectives for client assets that are not funds and securities.

Footnote 5 of the 2009 guidance, which discussed that "a material discrepancy is material non-compliance with the provisions of either Rule 206(4)-2 or Rule 204-2(b) under the Act" referenced AT 601 of the AICPA attestation standards. That AICPA AT section has been superseded. The new AICPA attestation guidance for compliance attestation engagements is AT-C Section 315 *Compliance Attestation*.

The AICPA Audit and Accounting guide *Investment Companies* currently includes an illustrative example of an internal control report that conforms to the requirements of AT-C Section 205 and is applicable when the investment adviser or its related person maintains client funds or securities as a qualified custodian in connection with advisory services provided to clients. We recommend that the SEC final rule acknowledges that an internal control report that conforms to the requirements of AT-C Section 205 would also satisfy the rule's requirement for the internal control report.

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[7] Page 156, Question 151: "Rather than requiring verification by an accountant promptly after each transfer, as proposed, should the rule require, as part of the annual surprise examination or annual audit, an accountant to verify holdings of privately offered securities from one year to the next and evaluate discrepancies?"

[8] Page 160, Question 160: "Should the verification requirement permit sampling of client accounts, as opposed to verification of assets for all client accounts"

[9] Page 155, Question 144: "Would the 2009 Accounting Guidance contain sufficient guidance for an accountant that is engaged to perform the proposed verification procedures around privately offered securities and physical assets that are not maintained with a qualified custodian? What changes, if any, do you believe would be necessary to provide adequate direction with respect to the proposed verification procedures?"

Thank you for the opportunity to comment on the proposed rules regarding safeguarding client assets. We are happy to discuss any of the above-mentioned concerns and suggestions in further detail as the SEC works through this rulemaking. For any questions or clarification, please contact Kate Kiley, Kate.Kiley@aicpa-cima.com or 202-434-9219.

Sincerely,

Susan S. Coffey, CPA, CGMA
Chief Executive Officer – Public Accounting