April 13, 2023

Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: **File No. S7-04-23; Release No. IA-6240**

Summary Response

The SEC wishes to limit discretionary trading by Registered Investment Advisers through the Safeguarding Advisory Client Assets rule. Yet, it has not provided examples of how discretionary trading will protect the public or prevent the misappropriation of funds anywhere in the 434-page proposed rule.

Every example of potential harm from discretion referenced in the proposed rule is an example of discretion *plus* custody, not discretion itself. Lumping these terms together does not reflect how a firm manages a client relationship and will prevent Advisers from managing the entire net worth of a particular client.

For example, today, Advisers can obtain login credentials to place trades in a client 401k if it does not grant withdrawal or distribution authority on the account. Under the proposed rule, ensuring proper allocation and timely rebalancing of these assets would be prohibited even though no scenario exists where the adviser could misappropriate the funds.

If the login did contain access to process distributions, that is an example of custody. The Adviser now has discretion *plus* custody. These terms are continually lumped together throughout the proposed rule, confusing terms widely understood by Advisers.

Definitions

Discretionary Authority, Discretionary Basis, or Discretionary Trading Authority
Your firm has discretionary authority or manages assets on a discretionary basis or has discretionary trading authority if it has the authority to decide which assets to purchase and sell for the client without consulting the client. Your firm also has discretionary authority if it has the authority to decide which investment advisers to retain on behalf of the client without consulting the client.
(Page 427 of Proposed Rule)

Discretionary Authority
Additionally, the definition of Discretionary Authority or Discretionary Basis would be expanded to include Discretionary Trading Authority.
(Page 209 of Proposed Rule)

What is Custody?
Custody by investment advisers means holding client funds or securities, directly or indirectly, or having the authority to obtain possession of them.
(https://www.sec.gov/investor/alerts/bulletincustody)

Note that the SEC has defined Discretionary Trading as buying and selling assets, and there is no reference to assets entering or leaving the account.

Erroneous Examples of Discretion

Page 13:
Discretionary trading practices today, however, do not necessarily involve a one-for-one exchange of assets under a custodian's oversight. For instance, an adviser may instruct an issuer or a transfer agent that recorded ownership of a client's privately offered security to redeem the client's interest and direct the proceeds to a particular account.

The example above is two transactions, a trade (discretion) and a withdrawal (custody). If an Adviser has the authority to direct a trade settlement to an account the trade did not originate from, that is an example of custody. Directing proceeds to a specific account is a different action from the trade itself.

Page 20-21:
When an adviser has discretion to trade client assets, it has an arrangement in which it may instruct the adviser's custodian to dispose the client's assets. An adviser with discretion may also have broad authority to direct purchases or sales of client assets that may not currently involve a qualified custodian, such as loan participation interests. An adviser's ability or authority to effect a change in beneficial ownership of a client's assets, including for purposes of trading, could place client assets at risk of loss that the rule is designed to address.[36] This change would rectify any unintended consequences of our prior interpretive position.[37]

It is unclear what is meant by the term "dispose," as it is not an industry term and does not appear anywhere else in the 434 pages.

If we assume "dispose" means misappropriation of funds, this relates to the Adviser directing assets out of the client account. This is an example of custody, not discretion.

The issue continually highlighted in the proposed rule appears to be trades placed by Advisers that settle on a non-DVP basis (like the loan participation interest example above). In my firm and with other Advisers I have spoken with, there are limited non-DVP transactions.

If this trend is consistent industry-wide, it would be unfortunate to hamper the routine practices of virtually all Advisers to address outlier and edge cases of private securities trading.

Page 32:
Proposed rule 223-1(d)(3) (proposed custody definition) and proposed rule 223-1(d)(4)(discretionary authority definition). The second prong of the current custody definition

states: "Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian." See current rule 206(4)-2(d)(3).

Discretionary authority is again tied to a withdrawal of client funds. Discretion does not, and cannot, give an Adviser authority to withdraw client funds. That is called custody. An active Power of Attorney **granting the power to withdraw funds** would also be custody.

Page 33:
The adviser, for instance, could use its discretionary authority over a client's assets to instruct an issuer's transfer agent or administrator (e.g., the administrator for a loan syndicate) to sell its client's interest and to direct the cash proceeds of the sale to an account that the adviser owns and controls, thereby depriving the client of ownership, unbeknownst to the client or its qualified custodian.

If an Adviser chooses to commit theft or fraud, it is unclear how the proposed rule would prevent this. Virtually all Advisers operate in good faith and do not take money from their clients.

Bad actors in the industry do not steal funds by exploiting loopholes in the rules, they do so by committing forgery or fraud. In the scenario above, an Adviser could place the trade on a non-discretionary basis and direct the proceeds to an inappropriate account. The trading authority is not an element of the misconduct.

The Adviser could not under any circumstances use discretionary authority to direct the sale proceeds to their own account. That is called fraud, not discretion. The example also fails because they are directing the *cash* proceeds to an advisor account; the trade preceding the transfer is a separate event and is irrelevant to the scenario above.

Page 273:
Investment advisers may accordingly eliminate the aspect of their services that gives them custody (they may decline the authority to hold or take possession of the other assets, including any discretionary authority to withdraw or transfer beneficial ownership of such assets).

The term "discretionary authority" is being obfuscated and used inconsistently, leading to unrealistic examples. Discretionary authority means trading authority, it has nothing to do with the withdrawal of funds or transferring of beneficial ownership.

Page 275 – 276:
The proposed rule would explicitly identify discretionary trading authority as an arrangement that triggers the rule. An adviser with this ability or authority can subject a client's assets to the risks of loss, misuse, misappropriation, theft, or financial reverses of the adviser.

A trade for a client can result in a gain or loss on that particular investment. Fraudulently directing the proceeds out of the client's account is theft. It is unclear how trading can lead to theft.

Regardless, Advisers are rarely involved in the settlement of a trade and typically do not have access to change the account funds would be settled in. If the issue is crimes of opportunity with non-DVP trading, then specific rules for non-DVP trading would be appropriate.

Page 276:
The authority for discretionary trading presents the kinds of risks to client assets that the rule is designed to address. When advisers have this authority, they have the ability to sell or purchase assets for the client's account without first obtaining client consent. This creates an opportunity for an adviser to put those assets at risk of loss, misuse, misappropriation, theft, or financial reverses of the adviser.

Advisers do obtain client consent, in writing, before placing trades on the client's behalf. Clients request this service so their accounts can be managed efficiently, and they don't have to approve every transaction. This is a feature for clients, not a bug.

The example above makes a theoretical leap to the misappropriation of funds without providing the core logic of how this would occur.

Comment Response: Scope of Activity Subject to the Proposed Rule

We request comment on all aspects of the proposed application of the rule to advisers with discretionary authority, along with the continuing application of the rule more generally, including the following items.

8. *Should the proposal generally retain the current rule's definition of custody? The proposed rule would generally retain the three categories that serve as examples of custody in the current rule: physical possession, certain arrangements when the adviser is authorized or permitted to withdraw or transfer beneficial ownership of client assets upon the adviser's instructions, and circumstances when the adviser acts in certain capacities. Should the proposed rule change the current definition of custody from these three categories? What should the proposal provide alternatively?*

   "Circumstances when the adviser acts in certain capacities" appears to be an indirect reference to discretion and should be excluded from the definition of custody. Trading authority presents no greater risk of misappropriation of funds than an Adviser receiving a duplicate statement.

9. *Should the rule apply to when an adviser has discretionary authority over client assets, as proposed? Are there provisions of the proposed rule that should or should not apply to advisers who have custody because they have discretionary authority?*

   No. According to the SEC's own definition of discretion, custody and misappropriation of funds are not possible with discretion alone. The SEC is proposing a set of rules where we can effectively manage client assets at a Qualified Custodian while their other assets,

including employee-sponsored retirement funds, are given second-class status.

I can assure you the client cares equally about all of their wealth, regardless of what type of custodian the funds are at, and expects the same level of service from their Adviser on all assets.

10. *Do advisers with discretionary authority over a client's assets (regardless of settlement method) currently have safeguards in place that effectively limit the risks to clients of loss, misuse, theft, or – in particular – misappropriation? If so, what are they? Do these safeguards differ depending on whether the arrangement involves a qualified custodian?*

    Yes, all Advisers with discretionary authority are guaranteed to have safeguards in place that would limit misuse, theft, and misappropriation. The safeguards are the laws of economics where simply placing a trade does not move money out of their account.

    Qualified and non-Qualified Custodians are both subject to these laws, and thus, the type of custodian is irrelevant.

11. *When a trade settles in a manner that is not DVP, are there controls that are or could be established in the event one leg of the trade does not complete? If so, how commonly are such controls utilized? Are there circumstances when such controls could not be established or implemented? Should we require controls or policies and procedures for advisers and/or the respective custodians in these circumstances?*

    DVP vs. Non-DVP is relevant to the discussion about custody, but not for discretion.

    If this question refers to the expanded definition of discretion proposed in the rule, then the solution is simple. An Adviser who can direct trade proceeds to an account in a different registration has custody. If they can't, it's discretionary trading and should not be included in the proposed rule.

Comment Response: Proposed Exception for Discretionary Authority

235. *Should we provide an exception from the requirement to obtain an independent verification of client assets if an adviser's sole basis for custody is having discretionary authority with respect to client assets that are maintained with a qualified custodian in accordance with the rule? Does providing such an exception from asset verification in these limited circumstances produce additional risks for client assets?*

     Of course there should be an exception. What would an independent accountant audit if the funds were at a Qualified Custodian, or any Custodian for that matter?

236. *Are we correct in our assessment that this proposed exception would better balance the costs and protections of the proposed rule?*

Yes. The objective of the audit, if the Adviser does not have possession or access to client funds, is unclear.

237. *Should we limit the exception to situations in which the qualified custodian implements certain policies and procedures? If so, what should they include? For example, would a qualified custodian need to demonstrate that it has certain systems, confirmations, or authorizations in place to ensure that an adviser is unable to initiate any one-way transactions and that the adviser's authority is limited to only trading?*

This question is irrelevant as it discusses withdrawals in the context of discretionary trading, which is impossible by the SEC definition.

If an adviser is unable to initiate any one-way transactions and the Adviser's authority is limited to trading, this should not be an exception; it should be the rule. The rule should state that the Adviser does not have custody, and custody does not include trading authority.

238. *Should we limit the exception to situations in which the adviser implements certain policies and procedures with regard to discretionary authority? If so, what should those policies and procedures be? If we were to rely more heavily on the adviser's policies and procedures, should we require external testing or auditing of those policies and procedures or internal controls? For example, should we require an internal control report with similar control objectives to the internal control reports we require under the custody rule or what we would require under the safeguarding rule?*

Advisers who steal money from clients are not deterred by the firm policies and procedures manual.

An internal audit for a firm with trading authority but not custody would not appear to be beneficial. All the cash flows are on the books of the custodian, it's unclear what would be measured on the Adviser side to test this.

Additional regulation raises the cost of compliance and disincentivizes smaller firms to stay independent and comply with increasingly complex and expensive regulations. This reduces competition and choice for the consumer, consolidating wealth at bigger firms (where most of the fraud occurs).

239. *Do commenters agree with our assessment of the risks to client assets as a result of discretionary authority in qualified custodian accounts? Do commenters agree with our assumption that a one-way transfer of assets from an account at a qualified custodian is a riskier form of discretionary authority than DVP transactions? Are*

there circumstances in a discretionary trading environment at a qualified custodian where risks of misappropriation or theft in an account are not mitigated by DVP settlement or requiring a one-for-one exchange of assets? If so, please provide such examples.

I do not agree with your assessment, as trading does not involve a transfer of assets from an account. Trading and transfers are separate events that have distinct definitions.

If the SEC wants to address "do non-DVP transactions constitute custody and increase the potential for abuse," that is a coherent and relevant topic to this rule and the Adviser industry.

240. *If an adviser's authority over an account with a qualified custodian includes the ability to transfer assets free of payment to another account with the same account title, should such an account still be eligible for the limited exception to the surprise examination?*

Of course. If not, the client would receive a lower level of service from the Adviser with no added benefit.

241. *Should this exception apply "solely" when the basis for custody is discretionary authority? Should we allow use of the exception when the adviser also qualifies for another exception that is similarly premised on an adviser "solely" having custody for a specifically identified reason, such as when an adviser has custody of client assets "solely" as a consequence of its authority to make withdrawals from client accounts to pay its advisory fee, or "solely" because a related person has custody of them in connection with the adviser's advisory services? Notwithstanding the use of "solely" in certain exceptions from the surprise examination requirement, these limited exceptions are not mutually exclusive; should they be?*

The optimal solution is to stop the charade that trading is related to custody in any meaningful way. Short of that, yes, it should be an exception.

Comment Response: Economic Analysis

G. Request for Comment

The Commission requests comment on all aspects of this initial economic analysis, including whether the analysis has: (i) identified all benefits and costs, including all effects on efficiency, competition, and capital formation; (ii) given due consideration to each benefit and cost, including each effect on efficiency, competition, and capital formation; and (iii) identified and considered reasonable alternatives to the proposed rule. We request and encourage any interested person to submit comments regarding the proposed rule, our analysis of the potential effects of

the proposed rule, and other matters that may have an effect on the proposed rule. We request that commenters identify sources of data and information as well as provide data and information to assist us in analyzing the economic consequences of the proposed rule. We also are interested in comments on the qualitative benefits and costs we have identified and any benefits and costs we may not have discussed.

280. The proposed rule affects banks and savings associations, broker-dealers registered with the Commission, futures commission merchants registered with the CFTC, and FFIs. How do rules and regulations of other financial regulators and of self-regulatory organizations affect these entities in their capacity as qualified custodians? How do these existing rules and regulations affect the benefits of the proposed rule and its costs?

The proposed rule also affects Registered Investment Advisers. By mandating the use of a Qualified Custodian and eliminating the number of Qualified Custodians through increased regulatory burdens, Advisers will inevitably provide management to a smaller portion of the client's overall net worth.

In an increasingly complex financial landscape, clients ask us for more help on their investments, not less. The SEC is eliminating our ability to ensure our client's investment portfolio is accurately implemented and managed across all accounts and asset classes.

281. The proposed rule would expand the scope of assets currently subject to the custody rule. To what extent do investors benefit from advisers having custody of assets newly scoped in under the proposed rule? What is the nature of those benefits? To what extent would those benefits be lost given the requirements of the proposed rule?

The benefit is not apparent, but the limitations are. Under the proposed rule, Advisers can only execute transactions for clients at Qualified Custodians.

Clients will not limit their financial interests to the products available at Qualified Custodians. Advisers don't create demand for investment opportunities, we build solutions to meet the demand in a manner that is best for the client. The SEC is removing one of the few layers of fiduciary protection the public has and forcing them to explore untested financial products without the assistance of a licensed professional.

282. The proposed rule would explicitly identify discretionary trading authority as an arrangement that triggers the rule. To what extent do investors benefit from discretionary trading services offered by investment advisers? What is the nature of those benefits? To what extent would investment advisers no longer offer discretionary trading services given the requirements of the proposed rule?

Investors benefit from discretionary trading services by having transactions executed in a timely manner by a licensed professional. If the Adviser is required to contact every client before a trade is placed, smaller and lower net-worth clients would have to wait until all of the large clients are called before the advisor made their way down the list.

Specific to this rule, an Adviser can no longer ensure the proper allocation of a 401(k) plan, update an investment option inside an annuity, or switch between a variable and fixed interest rate on an insurance policy.

More importantly, as new, innovative solutions are introduced to the public, they will be left without a fiduciary to ensure the accuracy of their transactions. Creators of financial products will view the regulatory hurdle of complying with the Safeguarding Advisory Clients Assets rule as too burdensome and market directly to an inexperienced public who must now fend for themselves.

As fiduciaries under the Investment Advisers Act of 1940, the SEC should encourage more banks, custodians, broker/dealers, hedge funds, and private exchanges to work with us, not fewer.

283. The proposed rule would generally require that the investment adviser maintain client assets with a qualified custodian pursuant to a written agreement between the qualified custodian and the investment adviser (or between the adviser and client if the adviser is also the qualified custodian). Do commenters agree that qualified custodians will have in incentive to provide written agreements that are consistent with the requirements of the proposed rule?

You are correct that existing providers of custodial services to Registered Investment Advisers will have the incentive to provide compliant written agreements.

It is incorrect to assume that new custodians, qualified or otherwise, will have the incentive to meet the compliance burdens proposed in the rule. They will be incentivized to exclude a fiduciary Adviser from the relationship between the client and the manufacturers of financial products.

Ultimately, the Adviser client will pay for the proposed rule with fewer options, higher costs, and a reduced level of service.