Brussels, 30 June 2023

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

**RE: Impact of the U.S. Securities and Exchange Commission's Proposed Safeguarding Rule on European Funds**

Dear Ms. Countryman:

This letter is respectfully submitted by the European Fund and Asset Management Association ("**EFAMA**")[1] in response to the Safeguarding Rule[2] proposed by the Securities and Exchange Commission ("**Commission**") on 15 February 2023 and published in the Federal Register on 9 March 2023 (the "**Proposed Rule**").[3] This letter is intended to highlight the impact of the Proposed Rule on EU, UK, and Swiss investment funds (hereafter "**European Funds**") where U.S.-registered investment advisers have been appointed to provide discretionary investment management services ("**U.S. Investment Managers**") – including Undertakings for the Collective Investment in Transferable Securities ("**UCITS**"), Alternative Investment Funds ("**AIFs**"), and any other national collective investment schemes where the depository is responsible for custody (and therefore the appointment of any sub-custodians).

## 1. Summary of Comments

The Commission has long taken the position "that most of the substantive provisions of the Advisers Act do not apply with respect to the non-U.S. clients (including funds) of a registered offshore adviser."[4] This is because, as the Commission has explained, "U.S. investors in an offshore fund generally would not expect the full protection of the U.S. securities laws" and "U.S. investors may be precluded from an opportunity to invest in an offshore fund if their participation would result in full application of the Advisers Act and rules thereunder."[5]

Despite this understanding, the Proposed Rule would impose new requirements on European Funds outsourcing their portfolio management function to a U.S. Investment Manager, even if

[1] EFAMA is the voice of the European investment management industry, which manages over EUR 28 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors. Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities.

[2] Proposed Rule 223-1 under the Investment Advisers Act of 1940, as amended (the "**Advisers Act**").

[3] *Safeguarding Advisory Client Assets*, 88 Fed. Reg. 14672 (Mar. 9, 2023), available at https://www.govinfo.gov/content/pkg/FR-2023-03-09/pdf/2023-03681.pdf ("**Proposal**").

[4] Proposal at footnote 3.

[5] *Id.*

these are not offered in the United States. In effect, the Proposed Rule would extend largely redundant yet expensive protections to these funds and would disincentivize them from appointing domestic U.S. Investment Managers for discretionary investment management services, resulting in substantially increased compliance costs for European Funds and less foreign investment into the United States. The Proposed Rule would also likely deprive many non-U.S. investors of the investment expertise of U.S. investment advisers.[6]

Because of such costs, and the seeming lack of a policy justification in the Proposal for imposing them, we ask that the Commission, to the extent it expands the definition of custody to include discretionary authority:

i) expressly exclude from the final rule non-US funds that are already subject to extensive safeguarding requirements, similar to registered investment companies in the United States; or
ii) expressly exclude non-US funds that are not offered in the United States since no investor in a fund only offered outside of the United States would have a reasonable expectation that the final rule would apply to such fund; or
iii) at a minimum, provide flexibility with respect to auditor independence and presentation standards for non-US funds under the final rule.[7]

We discuss these points in more detail below. First, we provide an overview of the legal frameworks that apply to funds and their depositaries in Europe. Second, we explain our concerns with imposing additional requirements on European Funds under the Proposed Rule.

## 2. Overview of European Legal Frameworks

As other commenters have noted, European Funds – UCITS,[8] AIFs,[9] and other national fund structures such as UK[10] and Swiss[11] collective investment schemes – are highly regulated. The

[6] As indicated in the EFAMA 2023 Factbook, EU Funds are an important vehicle for international portfolio investment. By the end of 2022, non-EU investors held in EU Funds EUR 4.4 trillion in Assets under Management (AuM). The unintended consequences described in this letter would therefore concern both EU and non-EU investors. The EFAMA Factbook is available at https://flipbook.vcpgraphics.online/EFAMA/Factbook/2023/Factbook2023.html#p=56

[7] The Commission has provided some foreign issuers similar flexibility in other contexts. *See, e.g.*, *Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP*, 73 Fed. Reg. 986 (4 Jan. 2008), available at https://www.govinfo.gov/content/pkg/FR-2008-01-04/pdf/E7-25250.pdf.

[8] EU Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to UCITS (recast) ("**UCITS IV**"). More recently, this Directive has been amended by Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to UCITS as regards depositary functions, remuneration policies and sanctions, available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0091&rid=1 ("**UCITS V**" and together with UCITS IV, the "**UCITS Framework**"). The UCITS Framework, as amended by UCITS V, is available at https://lexparency.org/eu/32009L0065/.

[9] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (the "**AIFMD Framework**"), available at https://lexparency.org/eu/32011L0061/.

[10] FCA Handbook on Collective Investment Schemes (the "**FCA Handbook**"), available at https://www.handbook.fca.org.uk/handbook/COLL/.

[11] Federal Act on Financial Institutions ("**FinIA**"), available at https://www.fedlex.admin.ch/eli/cc/2018/801/en. Federal Act on Collective Investment Schemes of 23 June 2006 ("**CISA**"), available at https://www.fedlex.admin.ch/eli/cc/2006/822/en. Ordinance on Collective Investment Schemes ("**CISO**"), available at https://www.fedlex.admin.ch/eli/cc/2006/859/en.

relevant legal frameworks impose several restrictions, requirements, and obligations on depositories. We briefly summarize some, but not all, of these provisions below.

European Funds can only appoint a fund depository that meets strict requirements. Moreover, a single independent depositary must be appointed for each European Fund.[12] As outlined in the UCITS Directive, the purpose of this requirement is to ensure that "the depositary has a view over all of the assets of the [fund] and both fund managers and investors have a single point of reference in the event that problems occur in relation to the safekeeping of the assets or the performance of the oversight functions."[13] This is the same in the other European frameworks. As a result, no entity may act as both a management company and depositary of a European Fund.[14] Also, the relevant European legal frameworks establish an extensive list of oversight duties that are incumbent on depositaries irrespective of the legal form taken by the fund. These include oversight duties, a cash monitoring role, and the safekeeping of assets.[15] Depositaries must also ensure that the fund assets are segregated from their own assets.[16]

These European frameworks also require that the accounting information given in the annual report of the fund be audited by one or more persons empowered by applicable local European law to audit accounts.[17] This requirement, in particular, creates significant practical issues with applying the Proposed Rule to EU Funds, as discussed in more detail in Section 3 below.

We believe that these and other protections included in these European legal frameworks obviate the need for additional regulation solely because a U.S. Investment Manager exercises investment discretion on behalf of a European Fund, especially when it is not offered in the United States.

### 3. Concerns with Extending the Proposed Rule to European Funds

In a significant expansion from the current Custody Rule,[18] the Proposed Rule would explicitly include discretionary authority within the definition of custody. As a result, under the Proposed Rule, a U.S. Investment Manager will be deemed to have custody of the European Funds' assets. However, as described above, European Funds are already subject to a comprehensive investor protection scheme that was amended in 2009, 2011, and 2014 to increase the level of protection offered to investors in response to the global financial crisis (including protections designed to safeguard client assets). Similarly, the Commission is proposing to adopt the Proposed Rule pursuant to Section 223 of the Advisers Act, which was passed as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**") in the aftermath of the global financial crisis. The European legal frameworks described above already achieve the precise policy goals that serve as the basis for the Commission's Proposed Rule with respect to European Funds.

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[12] UCITS Framework at art. 22(1); AIFMD Framework at art. 21(1); FCA Handbook, COLL 6.6A.7; CISA at art. 44a; CISA at art. 25(2).

[13] UCITS V at recital 12.

[14] UCITS V at recital 12; UCITS Framework at art. 25(1); AIFMD Framework at art. 21(4); FCA Handbook, COLL 6.9.2 G; FinIA at art. 33(3).

[15] UCITS Vat recital 14; UCITS Framework at art. 22(3), (4), and (5); AIFMD Framework at art. 21(7), (8), and (9); FCA Handbook COLL 6.6B.16-20; CISA at art. 72.

[16] UCITS V at recital 17; UCITS Framework at art. 22(5)(a)(ii); AIFMD Framework at art 21(8)(a)(ii); FCA Handbook COLL 6.6B.18(2)(a); CISO at art. 104.

[17] UCITS Framework at art. 73; AIFMD Framework at art. 22(2); FCA Handbook, COLL 4.5; CISA at art. 126.

[18] Rule 206(4)-2 under the Advisers Act.

The Commission has not explained why a whole product class that has either very few, or no, U.S. investors, and often is not even offered in the United States, needs to be subject to both U.S. and European safeguarding protections that accomplish the same goal of ensuring that client assets are kept safe simply because there is a U.S. Investment Manager involved.

Moreover, the application of the Proposed Rule to European Funds is of particular concern with respect to annual audits. As noted above, the European legal frameworks already require European Funds to have auditors that meet independence standards, which can differ from Regulation S-X standards. As a result, many "independent" auditors in Europe would not meet the Proposed Rule's independence standards. Yet, under the Proposed Rule, a European Fund that has appointed a U.S. Investment Manager for discretionary investment management services would need to have an auditor that meets the independence requirements of Regulation S-X and that is engaged based on the periods dictated by Regulation S-X, which would impose additional costs without any meaningful benefits. Moreover, a European Fund that relies on the annual audit requirement under the Proposed Rule would be required to reconcile material differences between their annual audit with U.S. GAAP. While European Funds are required to be audited, their financial statements are generally presented in accordance with local standards, which can differ from U.S. GAAP. These overlapping requirements serve no helpful purpose, particularly for European Funds that are not offered in the United States. Applying these overlapping standards is extremely burdensome and expensive, and it is often difficult to even find a single auditor that can meet all these requirements, which would result in a European Fund needing two auditors to satisfy both the standards in the fund's country of domicile as well as U.S. requirements. Even for those European Funds that are offered in the United States via a private placement, the vast majority of investors in such funds are non-U.S. persons.

Relatedly, the Commission has historically excepted registered investment companies from the Custody Rule (and they continue to be excepted from the Proposed Rule) given the existence of a separate regulatory framework that offers commensurate protections.[19] The same logic should apply in this context. Because European Funds are presently subject to robust regulatory frameworks designed to safeguard client assets from misappropriation, the Proposed Rule would impose enormous additional burdens on these funds while offering minimal—if any—additional protections to investors. In addition, these investors could ultimately indirectly bear increased costs as a result of the Proposed Rule without any meaningful expansion in investor protections.

## 4. Conclusion

Considering the above, we strongly urge the Commission to adopt one of the alternatives that we set out at the beginning of this letter. Should the Commission weigh the costs of the Proposed Rule as applied to non-US funds against the minimal benefits that would be obtained by imposing these additional obligations on those funds that appoint a U.S. Investment Manager for

[19] In particular, in the 2002 proposing release for amendments to the Custody Rule, the Commission explained that, "We propose to exempt advisers from the rule with respect to clients that are registered investment companies. Registered investment companies and their advisers must comply with the strict requirements of section 17(f) of the Investment Company Act of 1940 and the custody rules we have adopted under that section. We believe that applying rule 206(4)–2 in addition to those requirements may not increase safeguards on investment company assets." *Custody of Funds or Securities of Clients by Investment Advisers,* 67 FR 48579, 48584 (25 July 2002), available at https://www.govinfo.gov/content/pkg/FR-2002-07-25/pdf/02-18698.pdf. *See also Custody of Funds or Securities of Clients by Investment Advisers*, 68 FR 56691 (1 Oct. 2003), available at https://www.govinfo.gov/content/pkg/FR-2003-10-01/pdf/03-24813.pdf.

discretionary investment management services, we believe that the Commission will agree that all or most such funds should be excluded from the final rule.

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We appreciate the opportunity to highlight the impact of the Proposed Rule on European Funds and are grateful that the Commission has allowed us to submit a comment letter on this important Proposal. For further details, please contact the undersigned at info@efama.org, Julien Bourgeois of Dechert LLP at (202) 261-3451, or Derek Manners of Dechert LLP at (202) 261-7759.

I thank you for your consideration and remain at your disposal.

Yours sincerely,

Tanguy van de Werve
Director General,
EFAMA

cc: Julien Bourgeois, Partner, Dechert LLP
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