american securities association
America's Voice for Main Street's Investors

October 30, 2023

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

**Re: Safeguarding Advisory Client Assets; Reopening of Comment Period (Release No. IA–6384; File No. S7–04–23)**

Dear Ms. Countryman,

The American Securities Association (ASA)[1] submits these comments in response to the Securities and Exchange Commission's (SEC) reopening of the comment period for its proposal, Safeguarding Advisory Client Assets which proposed a new rule under the Investment Advisers Act of 1940 that would redesignate and amend the current custody rule (Proposal). While we agree the safeguarding of customer assets is a sacrosanct principle of investor protection under our securities laws, we have several concerns with the current proposal that we believe warrant serious consideration.

## I. General Comments

We support the SEC's fundamental goal of ensuring investor protection and the security of client assets from potential misuse or loss. Nevertheless, we have reservations about the Proposal in its current form. If implemented without amendments, it will substantially encumber the capacity of our member firms' financial experts to serve advisory clients and hinder their role as a recognized custodian. Our apprehension lies in the potential unintended consequence which could restrict the array of advisory services accessible to retail investors, amplify those same investors' expenses, and encourage a movement towards industry consolidation in the realm of qualified custodian services.

[1] The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership base that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

## II. The Proposal is Too Broad

The Proposal cites "significant developments" in cryptocurrencies as a key justification for new rules. However, the Proposal's overly broad definition of "custody" could inadvertently encompass a wide range of assets beyond the intended focus on cryptocurrencies.

Like many other proposals, this one risks extending the SEC's regulatory oversight into areas that fall under other regulators' purview, including derivatives, real estate, commodities, and art. The Proposal also would inappropriately deem every discretionary relationship to be a custodial relationship, which is problematic because discretion, generally, does not equal custody.

We believe the SEC has gone too far and should significantly tailor the Proposal to avoid unnecessary regulatory overreach and maintain clarity in regulatory jurisdiction.

## III. The Proposal is Burdensome for Small and Mid-Sized Advisers

The proposal's numerous additional requirements will disproportionately burden small and mid-sized advisers, potentially diverting resources away from investor services and innovation. These additional requirements also impose significant compliance burdens and data retrieval challenges. For example, the implied requirement that advisers conduct oversight of custodians – discussed further below – will directly impact smaller advisers who have finite resources.

Further, the Proposal would require three separate agreements (Custodian and Client, Custodian and IRA, and IRA and Money Manager) at the account level, introducing onerous administrative burdens. For instance, consider the scenario of a firm maintaining brokerage and advisory accounts but opts to custody advisory assets with a custodian. This business model necessitates multiple custody agreements between the investor and different parties, including the money manager, custodian, and the advisory firm. This fragmentation can be perplexing for investors that may not readily understand who is actually responsible for safeguarding their savings.

This would require investors to sign numerous agreements leading to a substantial increase in workload, impacting firms of all sizes but in particular, small and mid-sized firms. Additionally, qualified custodians may seek significant compensation to agree to these burdensome conditions or opt to decline such arrangements altogether.

The costs of these mandates will fall directly on advisers and their clients. One potential consequence is that some advisers may establish account or client asset minimums in order to make the rules workable from a cost-benefit perspective. Investors with smaller accounts or a relatively lower net worth may be cut off from services and products they need to grow their retirement and other savings. Here, the SEC rule purposefully rejects financial inclusion by minimizing access for lower income individuals looking to save and build wealth.

Furthermore, the proposed regulations do not explicitly address situations where discretion is required, such as in the case of cash sweep programs. For instance, a firm may exercise discretion over the allocation of cash in a sweep program, and this may require additional agreements with customers to dictate where their funds are allocated today versus tomorrow. This could introduce further complexity into the process and increase the administrative burden on both financial institutions and investors.

## IV. Negative Impact on Investors

The Commission understands the investment environment in the United States has evolved. It has transitioned from a time when individuals relied on professionally managed corporate pension plans to secure their retirement, to a new era where each person is responsible for their own savings, investments, and crucial financial choices to ensure a comfortable retirement and other life objectives.

Many of these individuals often lack the expertise, time, and discipline to make the best investment decisions and, as a result, can benefit from discretionary investment management services. However, the Proposal generally increases the cost of providing discretionary advice and gives preference to affiliated advisers over independent advisors.

The proposal's potential for increased costs, restrictions on access to advisory services, and reduced investment returns for investors is a concern. One of the major issues revolves around the restriction of access to financial products and services. This restriction is likely to be brought about by the requirement for written agreements, which could lead firms to limit offerings made to current and prospective clients.

Additionally, the Proposal would empower the largest third-party custodians (many of whom fall into the “too big to fail” category) and put them in a position of deciding which advisers they choose to work with and incentivizing advisers to adopt their own service offerings. The consequences of this consolidation – and the potential anticompetitive risks for investors it presents – are explored nowhere throughout the Proposal.

The Proposal also departs substantially from existing market practice. Advisers would effectively have to compel custodians to adopt certain policies and procedures to comply with aspects of the Proposal. This would be an unprecedented expansion of the SEC’s custody rules and will prove to be difficult to implement in practice.

## V. Regulatory Overlap

The Proposal overlaps with existing regulations that address current adviser practices and offers no evidence to demonstrate that these existing regulations are insufficient. Any new requirements may result in increased fees and diminished access to advisory services for retail investors.

Additionally, advisers might opt to reject discretionary control of assets that trade without a delivery-versus-payment mechanism due to operational and execution complexities. Consequently, investors may find themselves obligated to self-manage these assets, even if they would have preferred the advantages of professional management services. It is essential to avoid regulatory duplication and unnecessarily harm investors both financially and in product offerings.

## VI. Pace of Rulemaking

The SEC should consider the interaction of this proposal with other finalized or proposed rulemakings, especially in the context of costly custody audits and related procedures. It is difficult to fathom this additional cost because the processes are typically conducted by third party and/or independent consultants, whom the Commission continues to empower. Therefore, the cumulative impact on industry and investors is woefully underestimated.

We also reiterate our concern that the transfer of wealth from regulated entities and investors who risk their own capital to the professional class of lawyers, consultants, and accountants continues to get worse under this regime.

## VII. Recommendations

We urge the SEC to work collaboratively with industry experts to gain a comprehensive understanding of the current custodial structure. The overarching concern is that these regulations might inadvertently lead to industry consolidation, create complexity for investors, and potentially hinder their ability to make informed decisions about their investments. We believe that the potential costs of the proposed amendments could outweigh the benefits, and adviser fees are likely to increase as a result.

Furthermore, we recommend that the SEC clearly identify the existing shortcomings that necessitate these extensive regulatory changes and provide concrete examples of how investors have been harmed. This would help ensure that any new regulations are well-targeted and truly serve the best interests of investors.

We appreciate the opportunity to provide these comments and look forward to ongoing dialogue and cooperation in shaping regulations that enhance investor protection while preserving the efficiency and innovation of the investment advisory industry.

Sincerely,

*Jessica R. Giroux*

Jessica Giroux
General Counsel
American Securities Association