October 30, 2023

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-109

Re: The SEC Proposed Safeguarding Rule (File No. S7-04-23)

Dear Ms. Countryman:

JPMorgan Chase & Co. ("**JPMorgan**") respectfully submits this supplementary letter responding to the U.S. Securities and Exchange Commission's (the "**Commission**") proposed new safeguarding rule, which would redesignate and amend the custody rule (the "**Custody Rule**"), current Rule 206(4)-2 under the Investment Advisers Act of 1940 (the "**Advisers Act**"), with proposed new Rule 223-1 under the Advisers Act (the "**Proposed Rule**").[1]

As a follow-up to our previous comment letter ("**May Letter**")[2] and discussions with the Commission and staff, we provide additional detail and specific recommendations. We acknowledge the importance of safeguarding client assets and investor protection, however, we do not believe the Proposed Rule is appropriately tailored to the Commission's goal of preventing loss, theft, misuse, or misappropriation of client assets by an adviser. For this reason, JPMorgan continues to strongly believe the Commission should repropose a less disruptive rule that would minimize unintended consequences to traditional financial markets. However, if the Commission decides to move forward with the Proposed Rule, we urge the Commission to consider the recommendations in the May Letter as well as this letter.

I. Executive Summary

The information provided in this letter and our recommendations can be summarized as follows (*see* Appendix A for specific rule mark-up suggestions):

- In Part A, we provide information on the robust disclosures custody banks provide regarding their clients' cash deposit accounts and the solutions available for clients to manage their cash. While we continue to support a removal of the cash segregation requirement, in the absence of such relief, we recommend an exception to the requirement for highly supervised and well-capitalized institutions that provide disclosures to their clients.

[1] Safeguarding Advisory Client Assets, Release No. IA-6240 (February 15, 2023), 88 FR 14672 (March 9, 2023) ("**Proposing Release**").

[2] *See* Letter from Teresa Heitsenrether, Executive Vice President, Global Head, JPM Security Services, and Troy Rohrbaugh, Executive Vice President, Head of Global Markets, JPMorgan Chase & Co., to Vanessa Countryman, Secretary, SEC, (May 8, 2023), *available at* https://www.sec.gov/comments/s7-04-23/s70423-187820-342904.pdf.

- In Part B, we provide information on the nature of assets that are held in custody, criteria for an asset to be custodied and various assets that are captured by the Proposed Rule for which the proposed requirements would be inappropriate. Rather than subjecting all types of assets to the Proposed Rule, the Commission should exclude assets for which the proposed requirements are unnecessary and impractical.
- In Part C, we provide information on the current framework of the risks for which custodians do or do not take liability. In line with the reasons provided in the May Letter, we recommend a minimum standard of liability limited to loss of client assets resulting from the qualified custodian's ("**QC**") own actions or omissions or events within the QC's control.
- In Part D, we discuss the current process for taking directives from clients regarding a Registered Investment Adviser's ("**RIA**") authority to effect transactions and operational impediments that would result from the proposed requirement. Rather than requiring QCs to supervise the RIA authority, the Commission should rely on enhanced internal controls to improve monitoring of such authority and supervision.
- In Part E, we provide a suggested framework for bringing the Proposed Rule in line with existing customer protections to permit rehypothecation.

II. Discussion

A. Segregation of Cash Requirement Should Not be Imposed on Institutions that are Highly Supervised and Well Capitalized.

In our May Letter, we argued that the Proposed Rule's segregation of cash requirement is unworkable and would result in reduced market efficiency and increased cost for clients.[3] Below, we offer additional detail on the disclosures and cash management solutions provided to custody bank clients and recommend a narrower approach to help address the Commission's concerns regarding cash while minimizing market disruption and negative impacts to clients.

i. Types of Agreements and Disclosures Provided to Clients In Relation to Cash Deposit Accounts and Cash Management Solutions

Within JPMorgan's Global Custody business, our clients are professional, sophisticated institutional investors, who typically assess their counterparty exposure for cash balances within their overall counterparty exposure frameworks and are equipped with tools to forecast and manage their exposures to a given counterparty. Within the industry, we understand that there are a number of agreements and disclosures typically made by custody banks to clients that clearly state that cash is deposited with the custodian as banker, meaning the custody bank entity contracting with the client owes a debt to the client for the return of such cash. In our experience, it is also common for custody banks to inform clients, such as in the custody agreement, that cash deposits will not be segregated from the bank's own cash, that the bank may

[3] May Letter at 5-6.

use the cash in the course of doing its own business, and that in the event of a bank failure, the relevant clients will rank as general depositors of the bank. It is our understanding that provided documents also typically explain to clients that their deposited cash is covered by relevant deposit insurance, such as Federal Deposit Insurance Corporation (FDIC) insurance, up to the pertinent limit. This information on deposit insurance coverage is provided in documents explaining a custody bank's custody services in detail to clients and typically also within the account opening documentation.[4]

In addition to these robust disclosures, various solutions exist for clients to manage their cash held at custody banks such as (i) cash projection reports which provide a forward view on expected cash balances enabling investors to make informed decisions on whether to hold funds with the custodian or to place into other vehicles, (ii) intraday reports on cash balances and changes thereto, (iii) the ability to wire out cash to other banks intraday and at end of day for placement into time deposits or other investment options, (iv) automated sweeps which can be configured by the client to move funds in excess of a client specified cash balance into off-balance sheet vehicles such as money market mutual funds, and (v) collateral management services.[5]

ii. *Operational Impediments Resulting from Cash Segregation*

As explained above, cash balances at a custody bank are held as general deposits and reflected on the custody bank's balance sheet as a liability to the client. This enables the custody bank to utilize and deploy cash in its ordinary course of banking operations, including making real-time credit decisions to support client activities. In doing so, custody banks provide tailored liquidity and foreign exchange services to clients, some of which include the extension of intraday liquidity, FX services, Continuous Linked Settlement, collateral management, sweep services, and securities lending. These crucial services allow advisory clients to navigate the complexities of markets, currencies and settlement cut-offs with high levels of efficiency and minimal friction. Under the Proposed Rule, custody banks would either be unable to provide a number of these services or offer them efficiently and cost-effectively.

If the Proposed Rule is adopted as drafted, it is unclear how cash segregation would work in practice. One likely outcome would be advisory clients having to open cash accounts at other banks to protect them from the insolvency of the custody bank. This would mean an exponentially increased number of separate deposit accounts being opened for each market or currency, which would not only create global inefficiencies in trading, settlement, and asset servicing, but prevent custody banks from providing the services described above. Without access to these services, clients desiring such services would be forced to engage in individual cash management and foreign exchange transactions. Such segregation would also likely delay

[4] Retail clients receive disclosures similar to those discussed in this letter when they open an investment wrap account. An example of these disclosures can be found at: https://www.chase.com/content/dam/chase-ux/documents/investments/jpmcap_adv2a.pdf.

[5] While JPMorgan Global Custody provides all of these solutions, other custody banks may provide slightly different cash management solutions to their clients.

settlements, as credit checks or pre-funding would need to be performed before processing any settlement, disrupting the Straight -Through-Processing (STP) of these core custody activities.[6] For example, if a client (under instruction of the RIA) purchases securities, the custody bank would check the availability of funds/credit facility on the cash account prior to processing the settlement. STP can be utilized if the cash account is held at the custody bank. If the cash is held at a third party bank, however, that process would become very complex, as the client would need to ensure full funding of all transactions with the custody bank to allow their release into the market. These additional interactions (multiplied over thousands of cash movements per day) would introduce delays and disrupt STP, and require advisory clients to maintain substantial excess cash balances to avoid settlement fails, which would negatively impact investment returns.

In addition, as noted in our May Letter, the Proposed Rule would likely not accomplish its objective of eliminating deposit risk. The establishment of separate cash accounts at other banks would merely shift deposit risk to another institution, which may have higher credit risk than the custody bank.

iii. Recommendation

As articulated in our May Letter, while we acknowledge the Commission's desire to have adequate investor protection for client cash, we do not support the proposed segregation of cash requirement as written. We believe the right approach is to leverage the existing prudential regulations and customer protection regimes that have been placed by regulators to ensure safety and soundness of banks, as well as disclosures and existing solutions that are currently provided to clients. While we continue to support the removal of the cash segregation requirement for banks as proposed in our May Letter,[7] an alternative approach, rather than requiring all QCs to segregate cash in a bankruptcy-remote manner, would be providing a safe harbor for highly supervised and well-capitalized institutions that (i) meet certain prudential standards, (ii) provide specific disclosures regarding how the client's cash is held, and (iii) offer clients the ability to transfer their cash out of the deposit account.[8] We believe this is a less onerous approach which would alleviate the Commission's concerns while minimizing disruptions to the services that benefit clients.

[6] STP refers to an automated process which allows transactions to be processed electronically without manual intervention.

[7] May Letter at 13.

[8] We believe the Commission has contemplated a similar safe harbor approach in question #23 of the Proposing Release ("Rather than requiring accounts of this type for all banks and savings associations, should the rule require accounts that protect client assets from creditors of a bank or savings association in the event of the insolvency or failure of the bank or savings association for a subset of these institutions that are not federally insured or OCC member banks? For example, should the rule require accounts of this type for state banks that are not members of the Federal Reserve System?"). Proposing Release at 54-55.

B. Rather than Subjecting All Types of Assets to the Proposed Rule, the Commission Should Exclude Assets for Which the Proposed Requirements Are Unnecessary and Impractical.

The Proposed Rule inappropriately expands the concept of custodial obligations to assets and transactions for which additional protection is unnecessary and compliance would be impractical or prohibitively costly. For certain assets (described further below) that are being scoped in as part of the Proposed Rule, it is difficult to see how the Commission's stated focus on "loss, theft, misuse or misappropriation"[9] of RIA-advised clients' assets applies to them, rather than to financial assets that are readily transferrable such as cash or securities. In the Proposing Release, the Commission has not referred, either specifically or generally, to abuse or misbehavior that has occurred or that might occur with respect to these assets, or demonstrated how such abuse or misbehavior could be avoided through the interposition of a custodian.[10] In addition, there are existing protections that alleviate these concerns and the additional protections of the Proposed Rule are not warranted. As requested by the Commission staff, we provide additional detail on the current framework for assets that are custodied as well as our suggested framework for narrowing the scope of assets for which the Proposed Rule should apply.

i. Asset Types Currently Covered in Traditional Custody

Custodians, such as JP Morgan, providing traditional custody services through either a global custody business or through their registered broker-dealer entities, generally custody financial assets that fall into one of two categories outlined below.

The vast majority of assets held in traditional custody today are so-called "dematerialized" securities, meaning securities for which there are electronic or book-entry records. These include listed assets such as equities, fixed income instruments, publicly offered fund shares, and money market instruments. A custodian holds these assets as agent on behalf of its clients at a local Central Securities Depository ("**CSD**"), either as a direct participant of the CSD, or through either an affiliate entity or a third-party sub-custodian who is the participant of the CSD. The books and records of the CSDs serve as the official books and records of securities locally issued, and as the settlement platform for the local market. Securities are typically held in omnibus accounts in the name of the custodian. The beneficial ownership remains with the underlying client as reflected in the books and records maintained at the custodian. When a security is sold, the change in ownership is recorded on those books and records. Similarly, in the case of registered shares, these are recorded at the registrar of the issuer of the securities in the name of the custodian (as nominee) or sometimes in the client's name. In the case of mutual funds, these are typically held at a registrar or transfer agent.

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[9] *Id.* at 13.

[10] A review of publicly available SEC enforcement actions demonstrates that cases involving misappropriation of assets by an RIA typically involve common fraud. As also discussed in Part D, we do not believe the Proposed Rule is an effective method of addressing fraud. *See* litigation releases concerning civil actions brought by the Commission in federal court and administrative proceedings instituted by the Commission, *available at* https://www.sec.gov/litigation/litreleases and https://www.sec.gov/litigation/admin.

To a much lesser extent, clients also engage custody banks to hold physical instruments, which are either held in the physical vault of the custodian or through a third party custodian's vault. Examples of these physical instruments include letters of credit, bonds or equities in paper form. In all of these cases, the customer's assets are only recorded in the customer's name and segregated from the proprietary assets of the custody bank.[11]

ii. Types of Assets and Transactions that Should be Excluded from the Scope of the Proposed Rule

Based on the nature of assets held in custody referenced above and long standing practice, custody has traditionally been understood to require the following elements: (i) the assets are freely transferrable; (ii) the custodian must be able to exercise possession or control over the assets (in accordance with the Commission's own definition of custody);[12] and (iii) the assets must be capable of being segregated from the custodian's proprietary assets. However, the Proposed Rule captures a wide range of assets that do not meet these criteria and cannot be custodied in the sense that term is traditionally used. The Proposed Rule expands the assets covered in the current Custody Rule from "funds and securities" to "funds, securities, or *other positions* held in a client's account."[13] These would include, but are not limited to, uncleared, over-the-counter ("**OTC**") derivatives,[14] securities financing transactions ("**SFTs**"), mortgage-backed securities ("**MBS**") transactions, including "to-be-announced" ("**TBAs**") obligations, specified pool transactions, collateralized mortgage obligations ("**CMOs**")[15], commodity derivatives, syndicated bank loans, futures, options on futures, cleared swaps, and precious metals held in unallocated accounts.

<u>Principal-to-Principal Transactions/Contracts</u>

The nature of contractual relationships of principal-to-principal transactions makes them less susceptible to misappropriation by the RIA. As referenced above, for such transactions, an entity cannot insert itself as a new counterparty or transfer the assets without the consent of the counterparties. Furthermore, as part of the process of adding new trading counterparties (the onboarding process), counterparties conduct "Know Your Customer" ("**KYC**") due diligence on

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[11] Cash is treated and held differently from the assets outlined above (*see* Part A).

[12] *See* 17 C.F.R. § 275.206(4)-2(d)(2).

[13] Proposed 17 C.F.R. § 275.223-1(d)(1) (definition of "Assets") (emphasis added).

[14] As explained in our May Letter as well as in Part E of this letter, related collateral and margin should also be excluded from the scope of the Proposed Rule.

[15] Specifically with respect to certain MBS transactions such as TBAs, specified pool transactions and CMOs, which often do not settle within one business day, imposing a custodial construct on such transactions for the time period between the trade date and contractual settlement date would add impractical and unnecessary operational inefficiencies. Once the relevant MBS transaction settles, the securities will become subject to the current Custody Rule along with any other securities.

those potential counterparties and they receive representations from the RIA regarding, among other things, the activities the RIA will conduct on their clients' behalf.

In addition, it would be impractical to apply the custodial construct to principal-to-principal transactions/contracts given their inherent characteristics.[16] These types of assets are bilateral contracts between two counterparties without the involvement of a custodian. They are generally not freely transferrable; they require an agreement between the contract parties to assign rights to others. In contrast to the custody of securities, ownership records are only maintained on the books and records of the counterparties.[17] As a result, the custodian does not have the ability to "maintain possession or control" the assets given its inability to act as the legal owner and participate in any change of beneficial ownership. Nor can they be held by a custodian in such a way that they are segregated from the custodian's own assets; again, they cannot be held by the custodian at all.[18]

Due to the structure of these contracts, a custodian is not capable of providing traditional custody type services, including the following: (i) settlement (a custodian is currently not involved in the transfer of rights to a third party which requires both contracting parties to agree to assign the obligations under these transactions), (ii) safekeeping (a custodian does not have possession and control to ensure that the client's entitlement to a security cannot be changed), and (iii) asset servicing (a custodian is currently not involved in the cash flows from these transactions which are generally exchanged directly between parties of the contract).

Syndicated Bank Loans

With respect to syndicated bank loans (and similar types of loans), the trading and settlement process for loan interests already involves various parties (e.g., collateral/fund administrator, trustees, settlement platform) independent of the RIA providing transfer controls and confirmations, in addition to an extensive documentation process relating to the transfer of loan interests and their beneficial ownership.[19] In addition, before the register of lenders for a particular loan is updated to reflect a new lender (and its acquisition of title to, and beneficial ownership of, an interest in the loan), a KYC due diligence process is conducted, which confirms the identity of the new owner of loan interests and requires proof of its relationship to the RIA. After settlement, there are additional processes that would clearly identify any misappropriation.

[16] These include, but are not limited to, OTC derivatives, SFTs, MBS (including TBAs and CMOs), and commodity derivatives.

[17] For principal-to-principal transactions/contracts, entitlements are recorded in the custodian's accounts with a CSD/registrar and the custodian can transfer the assets upon instruction from the client or its adviser, a custodian, who is not a party to the contract, cannot register these financial contracts in an account under its name (or in its nominee name).

[18] As also discussed in our May Letter, for these transactions, both sides are counterparties to an executory bilateral contract with mutual rights and obligations. These rights and obligations create a debtor/creditor relationship, not a custodial agent/client beneficial owner relationship, and they cannot be "segregated" from the financial institution/counterparty's own proprietary assets. *See* May Letter at 6-10.

[19] *See* Letter from Elliot Ganz, Head of Advocacy, Co-Head Public Policy, LSTA, to Vanessa Countryman, Secretary, SEC, (June 20, 2023), *available at* https://www.sec.gov/comments/s7-04-23/s70423-207879-419502.pdf.

For example, the collateral/fund administrator is obligated to match payables and receivables for all client transactions; if it identifies any mismatch in the payables and receivables in connection with a loan transaction, it will make inquiries to remedy the situation and seek to unwind the transfer if necessary. These controls help ensure that loans are not at risk of "loss, theft, misuse, or misappropriation" by RIAs, thereby also rendering the trade-by-trade accountant verification requirement unnecessary.

Futures, Options on Futures, and Cleared Swaps

With respect to futures, options on futures, and cleared swaps, the Proposed Rule would be unnecessary as there are sufficient regulatory and operational controls around the transfer of such assets that would make them less susceptible to loss, theft, misuse, or misappropriation by an RIA. These controls include prohibitions against off-exchange transfers and exchange rules that an RIA would need to comply with to change ownership of such assets. For example, Section 6(a) of the Commodity Exchange Act expressly requires the purchase or sale of a commodity for future delivery to be conducted on or subject to the rules of an exchange.[20] In addition, U.S. futures exchange rules such as the CME Rules[21] and ICE Futures U.S. Rules[22] generally prohibit the transfer of positions between different beneficial owners. Futures Clearing Merchants ("**FCMs**"), in particular, are subject to the CFTC's robust customer protection regulations and segregation requirements, with respect to handling of customer assets in general, that are uniformly applied to both retail and institutional customers.[23]

Unallocated Physical Commodities

For physical commodities held on an unallocated basis, which is a common structure for clients to hold commodities such as precious metals, the client has a claim on the custodian for the underlying commodity.[24] As also explained in our May Letter, this structure enables efficient trading by allowing the use of electronic platforms to execute and settle their trades into an unallocated account with reduced custodial costs. Under the Proposed Rule, however, the choice to hold their assets in this manner would not be available to advisory clients, as their claim would need to be manifested by physical commodities in order to be segregated from the custodian's assets. This would not only eliminate clients' choice to hold their assets in a manner that allows them their desired exposure to the asset and to freely and efficiently trade their

[20] *See* 7 U.S.C. § 6(a).

[21] *See* CME Rule 853.A.1.

[22] *See* ICE Rule 4.37(a)(i)(A).

[23] This is illustrated in FIA's Protection of Customer Funds Frequently Asked Questions ("**FIA FAQ**"), available at: https://www.fiadocumentation.org/fia/regulatory-guidance_1/protection-of-customer-funds-faq_2. For ease of reference, CFTC regulations that cover the concepts included in the Proposed Rule are also provided in the attached Appendix B.

[24] For commodities held on an unallocated basis, the custodian holds legal title to the commodity while the client holds a credit for its share. The benefits of this practice and the impact of the proposed segregation requirement of the Proposed Rule are further elaborated in the May Letter. *See* May Letter at 8.

assets. Consequently, requiring such assets to be held in compliance with the Proposed Rule would result in reduced choice as well as increased costs for advisory clients.

iii. Recommendation

As articulated above, the Proposed Rule is not appropriately tailored to the Commission's stated objective and would apply to a much broader scope of assets to which the stated concerns do not actually apply. For certain assets scoped in by the Proposed Rule described above, there are existing protections and controls in place to prevent misappropriation and compliance with the Proposed Rule would also be impracticable, costly, and would result in negative impacts on clients. Therefore, we urge the Commission to carefully consider its objective and whether existing controls adequately address their concerns, the need for additional requirements, added benefits of the proposed requirements, and the practicality of the requirements as applied to these assets in developing a more tailored approach without the negative impacts. At the very least, we recommend the Commission excludes from the definition of assets financial instruments, holdings, contracts, commodities or transactions (and related collateral or margin) which:[25]

1. require consent of the advisory client and/or counterparty in the contract or transaction for changing beneficial ownership of the asset or a party to the contract or transaction;
2. are subject to confirmation or transfer controls of third parties independent of the RIA;
3. are subject to a due diligence process confirming the identity of, and relationship between, the RIA and the RIA-advised client prior to entering into the transaction; or
4. are held in a manner specified by the client per the client's voluntary and informed consent in writing to the RIA.

We note that while we have tried to formulate the principles that would help identify the assets and transactions that should be excluded, the assets and transactions discussed in this section may not be exhaustive. Given the risk of unforeseen market impacts of the Proposed Rule, the Commission should initially consider inclusion of a narrow set of assets, to the extent necessary, and then potentially expand the scope only if there is an identifiable rationale to cover additional assets. Such a gradual and targeted approach would help enhance protections only where warranted and minimize unintended consequences.

C. <u>We Recommend a Minimum Standard of Liability Limited to Loss of Client Assets Resulting from the QC's Own Actions or Omissions and Events Within the QC's Control.</u>

In our May Letter, we explained that the Proposed Rule's reasonable assurances requirement regarding liability for losses resulting from sub-custodians and CSDs actions and omissions unreasonably expands the QC's assumption of liability to losses it has no ability to

[25] *See* May Letter at 13 for a detailed list of assets that should be scoped out of the Proposed Rule.

prevent or control, which would result in increased fees and reduced optionality and markets to invest in for RIA-advised investors. While our recommendation with respect to this proposed requirement remains, here we provide additional information regarding the disclosures clients receive about risks of investing in certain markets, the risks that custodians currently accept, and our rationale for why custodians should not accept risks outside of their control.

i. Types of Agreements, Disclosures, and Market Information Currently Provided to Clients Regarding Sub-Custodians, CSDs, and Market Practice and Risks.

As noted above, clients of JPMorgan Global Custody are professional, institutional investors, who have the expertise and resources to review and manage the risks involved in investing in a given market and holding assets with a custodian and the underlying network of sub-custodians and CSDs.

In our experience, prior to the appointment of a custody bank, and on a periodic basis, institutional clients and their RIAs perform extensive due diligence on the operational, technical and system capabilities of the provider, which often includes an onsite visit. Ad hoc visits (typically annual) are conducted to ensure continued compliance with their own internal due diligence requirement.

In order to assist them in this process, custody banks typically provide institutional clients with extensive information which, where available, is structured following market standards and is kept updated. With respect to JPMorgan Global Custody, examples include:

- For clients registered under the Investment Company Act of 1940,[26] we provide information concerning markets (including sub-custodians and CSDs in that market) per the SEC's Investment Company Act Rule 17f-7. This information is included in Depository Safekeeping Assessments (DSAs) and provides clients with information related to the settlement and safekeeping of assets in CSDs.
- We obtain and publish annual legal opinions secured to gain clarity on recognition of the nominee concept, asset segregation, enforceability of sub-custodian agreements, recoverability of assets and more in a given market/ country.
- We provide clients with Settlement System Market Practice Assessments (SSMPAs), devised to assist investors as an exposure identification tool, based on a comparison of the various elements of a particular settlement system to the generally accepted global best practices.
- For most markets, we provide clients with Investment Kits which outline the requirements, complexities, and nuances for market entry to support clients in their

[26] While this Proposed Rule does not apply to registered investment funds, this is included for completeness of information shared with clients.

account opening process, and Briefing Memos that discuss specific market risks or nuances.

In addition to providing these documents, JP Morgan Global Custody holds regular meetings with clients and RIAs and provides continuous information via client newsflashes and other communications on market conditions.

Custodial agreements generally make clear that clients invest in foreign markets at their own risk, and clients acknowledge that they are solely responsible for assessing and managing investment and country risk/exposure. Furthermore, clients receive a variety of information relating to investment/country risks prior to opening accounts and going live in a market.

ii. A Custodian's Current Liability Framework, Force Majeure, and Country Risk

While custodial agreements vary across firms and businesses, and the relevant contractual provisions can be the subject of negotiation between custodians and their investor clients, custodians are generally responsible for the loss of client assets that are held at a sub-custodian under many, but not all conceivable circumstances.

It is our understanding that custodial agreements generally authorize the custodian to appoint and utilize sub-custodians to hold financial assets and act on its behalf, and the custodian, in turn, commits to use reasonable care in the selection, monitoring and continued appointment of sub-custodians. In a typical custodial agreement, the custodian accepts liability for the client's direct losses resulting from the custodian's own fraud, negligence or willful misconduct in performing its duties under the contract.

While these agreements are typically negotiated, custodians would not be responsible for the loss of client assets that are held at a sub-custodian if those losses resulted from some other cause outside their control. For example, custodial agreements typically include a force majeure clause providing that the custody bank will not be liable for client liabilities resulting from causes beyond the reasonable control of the custody bank. Such clause usually lists specific examples of causes, including civil or labor disturbance, war, act of any governmental authority, or currency re-denominations, among others. Many custodial agreements also include a country risk clause, providing that the custodian will not be responsible for liabilities resulting from the risk of investing or holding client assets in a particular country or market. Such risks include risks arising from nationalization, expropriation, capital controls, currency restrictions or other governmental actions.

Our clients, along with their advisers, select their investment strategy, including in which markets they invest. The custodian does not determine in which markets clients (advised by their RIAs) invest, and does not take on investment risk (nor return). As a consequence, the allocation of risk for losses not resulting from the custodian's negligence and which the custodian cannot control should rightly fall on the investor client rather than on the custodian. To require otherwise would shift certain risks inherent in investing in a particular market to the custodian and away from the investor. If the Proposed Rule were to be adopted as written, it should be

expected that many custodians will decline to provide services in many international markets where they have no appetite for absorbing such risks.

With respect to FCMs, the CFTC's regulations set out eligibility standards for depositories used by FCMs, require the FCM to conduct initial and annual assessment of depositories, and require public disclosure by the FCM of depositories it uses. Accordingly, the limitations on liability, force majeure and country risk outlined above in the context of traditional custody not only apply in the FCM context, but the FCM's customers know before they choose to trade where their assets will reside, and can choose not to trade in that market and avoid the risk entirely. Additionally, FCMs are required to provide risk disclosures to customers prior to accepting orders or margin, expressly alerting customers that they can lose their entire investment, and that if they trade outside the U.S. their investments will be subject to the laws and regulations of the jurisdictions in which they trade, which may differ from U.S. laws and regulations.

iii. Recommendation

Based on the suggestions made in our May Letter as well as the above framework, we reiterate our recommended approach with respect to liability for sub-custodians and CSDs. JPMorgan recommends a minimum standard of liability for a client's loss of assets due to a QC's own actions or omissions or due to its failure to exercise reasonable skill, care or diligence in its selection or monitoring of a sub-custodian, in all cases subject to existing law or regulation applicable to such QC. *See* Appendix A. Any final rule should be consistent with the following principles:[27]

1. In no event should a QC be liable for any acts or omissions of a CSD.[28]
2. In no event should a QC be liable for any acts or omissions of a sub-custodian unless, with respect to a sub-custodian the QC has selected, the QC has failed to comply with the minimum standards noted above.
3. In no event should a QC be liable for losses due to events outside the QC's control, such as those related to force majeure and/or country risk.
4. Any standard of care should be in accordance with the standards prevailing in the relevant market in which the QC or sub-custodian operates.

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[27] We note that various businesses within JPMorgan and firms across the industry may apply different standards of liability for losses arising from acts or omissions of sub-custodians. While a one-size-fits-all approach may not be ideal, we believe the above recommendation is a minimum standard of liability that could be workable.

[28] "CSDs are highly regulated financial market infrastructures whose terms are governed by a rulebook and uniform participant agreements. Participants have extremely limited control over these CSDs and have no ability to negotiate participation terms. As such, it cannot be meaningfully said that the QC 'chooses' or 'delegates' its custody obligations to CSDs. CSDs are market infrastructures, and the risk of loss due to the CSDs is part of the risk profile of investing in that market." May Letter at 10.

D. The Commission Should Resort to Enhanced Supervision and Internal Controls to Improve Monitoring of RIA Authority.

The Proposed Rule imposes a written agreement between an RIA and a QC that "specifies [the RIA's] agreed-upon level of authority to effect transactions in the account as well as any applicable terms or limitations, and permits [the RIA] and the client to reduce that authority."[29] We provide additional information on the current process for taking directives from clients regarding the RIA's authority, operational impediments that would result from the proposed requirement, and our recommended approach to enhance monitoring the RIA's authority.

i. Custodian Protocols for Taking Directives from Clients Regarding the RIA's Authority to Instruct, Receive Statements, and Operate Accounts

Custody banks typically follow an elaborate process to onboard clients and open accounts, which involves the custody bank's onboarding team, the client and the client's RIA. As part of this process, each party is required to sign multiple documents, which include forms signed by clients to authorize the RIA to instruct over the account on its behalf and receive reporting. Specifically for JPMorgan Global Custody, clients also have the ability to determine the level of instruction and authority of the RIA over their account, under which the instructions that are not coming from an authorized sender or falling outside the types of instructions permitted for the RIA would not be processed by the custody bank.[30] This process helps mitigate the risk of misuse or misappropriation of assets by the RIA. The RIA is also actively involved in defining the specifics including how it will instruct over the account (e.g., SWIFT), types of reporting it wants to receive, and contact details as part of the account opening process before the account is activated. This happens through a number of standard forms which the adviser fills in with the assistance of onboarding experts on the custodian side. Once the account is opened, the custody bank sends a confirmation back to both the client and the RIA notifying all parties that the account is opened and the adviser's instruction and reporting authority over the account.

ii. Operational Impediments Resulting from QC's Monitoring of RIA Authority

The requirement for the QC to monitor the RIA's authority to instruct and operate accounts would result in significant operational disruptions. As also elaborated in our May Letter, custodians do not have access to agreements between clients and their advisers, nor do they have the information, expertise, or authority to understand the full context of each trading activity. In addition, the requirement would involve significant modifications to the STP of transactions, which would introduce substantial delays in settlement and reduce market efficiency. It would also not be possible for a custodian to fully automate the monitoring

[29] Proposed 17 C.F.R. § 275.223-1(a)(i)(D).

[30] This could include limiting the RIA's authority for free of payment securities transfers or external cash payments to help reduce the risk of misappropriation.

processes as each instruction would require careful interpretation and judgment as to whether a specific instruction falls within the RIA's authority. For this reason, even with significant technological enhancements, the proposed monitoring would not be possible for a substantial number of daily transactions that need to be settled, often reaching tens of thousands per day, within tight timeframes.

iii. Recommendation

We understand the Commission may not have intended to require the QC to validate that the RIA is operating within its remit pre-settlement on a transaction-by-transaction basis. While we acknowledge the Commission's concerns with fraud and misappropriation and efforts to specify the RIA's authority in order to prevent them, we do not believe the Proposed Rule is an effective solution to address such concerns. We believe fraud would be best addressed by reinforcement of RIA internal controls and enhanced supervision by the Commission. In this respect, JPMorgan supports the Investment Adviser Association's (the "**IAA**") general approach with respect to reinforcing internal controls, with focus on the RIA's duty to adopt and implement reasonably designed written policies and procedures to mitigate the risk of loss, misuse, and misappropriation in lieu of the various proposed requirements on QCs.[31] Requiring robust internal controls and compliance procedures for RIAs would provide the flexibility in calibrating safeguards that are tailored to the specific risks associated with different types of assets, advisory practices, and business models, without the negative consequences that would result from the Proposed Rule. We recommend that the Commission continues to further develop this approach in collaboration with the RIA community in determining an appropriately tailored solution that would effectively achieve the Commission's policy objective. We also observe that the Commission has continually enhanced its examination methods;[32] these tools combined with robust RIA internal controls would be more effective in accomplishing the Commission's objective without disrupting market efficiency which would result in negative outcomes for advisory clients' investments.

E. <u>The Proposed Rule Should be Amended to Permit Rehypothecation</u>

Section 275.223-1(a)(ii)(D) of the Proposed Rule would require the RIA to obtain reasonable assurances in writing from the QC that the QC will clearly identify the client's assets as such, hold them in a custodial account, and segregate them from the QC's proprietary assets and liabilities.[33]

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[31] *See* Letter from Gail C. Bernstein, General Counsel, Laura L. Grossman, Associate General Counsel, IAA, to Vanessa Countryman, Secretary, SEC, (May 8, 2023), *available at* https://www.sec.gov/comments/s7-04-23/s70423-189019-370362.pdf.

[32] "Compliance with Advisers Act requirements regarding custody, including accurate Form ADV reporting, timely completion of private fund audits by a qualified auditor and the distribution of private fund audited financial statements." SEC Division of Examinations, 2024 Examination Priorities (October 16, 2023) at 11.

[33] Proposed 17 C.F.R. § 275.223-1(a)(ii)(D).

As detailed in our May Letter, this requirement could be interpreted as a proposed prohibition on rehypothecation of certain assets held by broker-dealers in margin accounts, collateral received by dealers from clients in repurchase agreements, and margin received in derivative transactions. This is in contrast to existing customer protections regimes that require segregation (non-rehypothecation) of only the amount of assets as necessary for customer protection. The negative impacts of the prohibition of rehypothecation and the inconsistency of the Proposed Rule with existing margin rules of the Commission, the CFTC, and the PRs, are well detailed in our May Letter as well as several trade letters, and have been reiterated in multiple meetings with the Commission and it is our understanding that prohibition of rehypothecation may not have been intended.

We therefore recommend the Commission brings the Proposed Rule in line with existing customer protections regimes by providing exceptions to the segregation of client assets requirement to the extent: (i) the RIA client consents or authorizes permission in writing to re-use or rehypothecate the assets; or (ii) the QC complies with existing regulatory regime, as applicable. *See* Appendix A.

III. Conclusion

While JPM acknowledges the importance of safeguarding client assets, we do not believe the Proposed Rule is appropriately tailored to the risk of loss, theft, misuse, or misappropriation that the Commission has expressed concerned about. We have tried to highlight some examples of provisions of the Proposed Rule that should be revised, however, we urge the Commission to consider re-proposal as the next step, only after a careful evaluation of the need for additional protection, to avoid any unintended consequences.

*   *   *

JPMorgan appreciates the opportunity to comment on the Proposed Rule and provide our views on potential risks and recommendations on the topic of safeguarding client assets. We would be pleased to provide any further information or respond to any additional questions that the Commission or the staff may have. We look forward to continuing to engage with the Commission on this topic.

Very truly yours,

/s/ Teresa Heitsenrether

Teresa Heitsenrether
Executive Vice President
Chief Data & Analytics Officer
Previously Global Head of JPM
Security Services (until June 2023)

/s/ Troy Rohrbaugh

Troy Rohrbaugh
Executive Vice President
JPM Head of Global Markets

Cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner
Director, Division of Investment Management, William A. Birdthistle

APPENDIX A

SUGGESTED CHANGES TO THE PROPOSED RULE[34]

Below, we are providing suggested mark-ups of the Proposed Rule, with removed text in ~~strikethrough~~ and added text in bold underline.

Proposed Requirement	Suggested Rule Mark-Up
Scope of Assets § 275.223-1(d)(1)	Revise § 275.223-1(d)(1) as: (1) *Assets* means funds, securities, or other positions held in the client's account, where *other positions* do not include financial instruments, holdings, contracts, commodities or transactions (and related collateral or margin) which: (i) require consent of the advisory client and/or counterparty in the contract or transaction for changing beneficial ownership of the asset or a party to the contract or transaction; (ii) are subject to confirmation and transfer controls of third parties independent of the RIA; (iii) are subject to a due diligence process confirming the identity of, and relationship between, the RIA and the client prior to entering into the transaction; or (iv) are held in a manner specified by the client per the client's voluntary and informed consent in writing to the RIA.
Liability for Sub-Custodians § 275.223-1 (a)(1)(ii)(B) & (C)	Revise § 275.223-1 (a)(1)(ii)(B) as: (B) The qualified custodian will be liable to ~~indemnify~~ the client ~~(and will have insurance arrangements in place that will adequately protect the client) against the risk of~~ for the 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, in accordance with the standards prevailing in the relevant market in which the qualified custodian or sub-custodian operates; Revise § 275.223-1 (a)(1)(ii)(C) as: ~~(C) The existence of any sub-custodial, securities depository, or other similar arrangements with regard to the client's assets will not excuse any of the qualified custodian's obligations to the client~~ (C) The qualified custodian will use reasonable skill, care and diligence in its selection and monitoring of sub-custodians;

[34] Note these suggested changes are not comprehensive.

Segregation of Client Assets § 275.223-1(a)(1)(ii)(D)	Revise § 275.223-1(a)(1)(ii)(D) as: (D) 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, except to the extent agreed to or authorized in writing by the client; Add the following to § 275.223-1(b) Exceptions: (_) *Permitted use of client assets*. Nothing in this section shall be construed to prohibit a qualified custodian from, directly or indirectly, pledging, repledging, hypothecating, rehypothecating, selling, lending, investing or otherwise transferring or using client assets to the extent such qualified custodian has obtained the client's written consent or authorization or is otherwise permitted to do so under applicable law or regulation. (_) *Segregation of Assets for FCMs.* You are not required to comply with paragraph (a)(1)(ii)(D) of this section if the qualified custodian as defined under paragraph under (d)(10)(iii) is an entity subject to 17 C.F.R. 1.20, 17 C.F.R. 30.7, or 17 C.F.R. 22.
Definition of QC for FCMs[35] § 275.223-1(d)(10)(iii)	Revise § 275.223-1(d)(10)(iii) as: (10) *Qualified custodian* means: (iii) A futures commission merchant registered under section 4f(a) of the Commodity Exchange Act (7 U.S.C. 6f(a))~~, holding the client assets in customer accounts, but only with respect to clients' funds and security futures, or other securities incidental to transactions in contracts for the purchase or sale of a commodity for future delivery and options thereon;~~

[35] The limitations to the customer account and to securities need to be removed. As the Proposed Rule purports to cover additional assets, having this limitation in the definition of FCMs as QCs would prohibit RIAs from accessing the full suite of products supported by FCMs.

APPENDIX B[36]

EXISTING CFTC REGULATIONS DEMONSTRATE THAT THE SEC'S PROPOSED REQUIREMENTS SHOULD NOT APPLY TO FCMS

No.	SEC Proposed Requirement	Existing CFTC Requirement
1	*Proposed Rule 223-1(a)(1)(i).* Written agreement between FCM and the adviser that must include the following provisions, which the adviser must reasonably believe have been implemented.	An FCM and its customer enter into a written agreement governing the principal-agent relationship between the parties. When an FCM deposits such customer's funds with a depository, the FCM must comply with various regulatory requirements. For example, CFTC Regulation 1.20(d)(1) requires the FCM to "obtain a written acknowledgment from each bank, trust company, derivatives clearing organization, or futures commission merchant prior to or contemporaneously with the opening of an account by the futures commission merchant with such depositories; provided, however, that a written acknowledgment need not be obtained from a derivatives clearing organization that has adopted and submitted to the Commission rules that provide for the segregation of futures customer funds in accordance with all relevant provisions of the Act and the rules in this chapter, and orders promulgated thereunder". The written acknowledgment must be in the form set forth in Appendix A to Part 1 of the CFTC's regulations. CFTC Regulation 1.20(d)(2). Based on this transparency, an adviser may reasonably believe that an FCM and its depositories are appropriately safeguarding customer funds. The SEC's proposed requirement is not necessary.

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[36] Appendix B is copied with permission from FIA's comment letter dated May 8, 2023. We are including Appendix B at the request of the Commission staff and also to emphasize the importance of carefully evaluating the existing regulations to identify specific gaps and propose requirements that would be additive in achieving the Commission's objective and remove those requirements that are superfluous or inconsistent. If such requirements cannot be removed, we recommend the Commission harmonizes the proposed requirements with the existing regulations to avoid inconsistences and unintended consequences. *See* Letter from Allison Lurton, General Counsel and Chief Legal Officer, Futures Industry Association, to Vanessa Countryman, Secretary, SEC, (May 8, 2023), *available at* https://www.sec.gov/comments/s7-04-23/s70423-187079-341082.pdf.

No.	SEC Proposed Requirement	Existing CFTC Requirement
2	*Proposed Rule 223-1(a)(1)(i)(A).* The qualified custodian will promptly, upon request, provide records relating to your clients' assets held in the account at the qualified custodian to the Commission or to an independent public accountant engaged for purposes of complying with paragraph (a)(4) [independent verification by an independent public accountant], (b)(1) [exception for mutual fund shares], or (b)(4) [exception from annual audit requirement for the account of a pooled investment vehicle if it undergoes a financial statement audit at least annually and upon liquidation] of this section.	An FCM may only deposit futures customer funds with a depository that agrees to provide the director of the Market Participants Division (MPD) or such director's designees, with direct, read-only electronic access to transaction and account balance information for futures customer accounts pursuant to CFTC Regulation 1.20(d)(3)(ii). The written acknowledgment must contain the FCM's authorization to the depository to provide such access to the director of MPD or its designees, without further notice to or consent from the FCM. In addition, to be an acceptable depository to hold CFTC regulated customer funds the FCM must instruct each depository to report balances held at the depository to the NFA (*see* NFA Financial Requirements Section 4(b)(c)(d)) and CME (*see* CME Rule 971.C). All FCMs must submit a daily segregated, secured 30.7 and Cleared Swap Customer account statement, as applicable, through electronic transmissions by 12:00 noon on the following business day. *See* CFTC Regulation 1.32; NFA Financial Requirements Section 16(e)(iii) and CME Rule 971.B. Reported depository balances are compared against applicable segregation statements by the CME or NFA to identify any material differences in asset balances reported by the FCM versus those reported by of the depositories. FCMs already provide frequent statements to customers and are subject to robust regulatory oversight that could include disciplinary action in the event of noncompliance. The SEC's proposed requirement is not necessary.
3	*Proposed Rule 223-1(a)(1)(i)(B).* The qualified custodian will send account statements, at least quarterly, to the client, or its independent representative, and to you, identifying the amount of each client asset in the account at the end of the period and setting forth all transactions in the account during that period, including investment advisory fees. Such account statements shall not identify assets for which the qualified custodian lacks possession or control, unless requested by the client and the qualified custodian clearly identifies any such assets that appear on the account statement.	FCMs already provide account statements to customers under CFTC regulations. Unlike the securities practice whereby advisory clients open accounts with custodians, futures and cleared swaps customers may not open their own accounts. Rather, they must deposit margin collateral with an FCM, which, in turn, opens an account with a depository to hold such funds subject to the CEA and CFTC regulations. An FCM must send account statements on a more frequent basis – monthly – to each customer and investment adviser. For the FCM the customer is defined as the legal entity whose margin collateral is at risk. In addition, an FCM must provide customers with written confirmation of each commodity interest or commodity option transaction (including foreign futures or foreign options transactions under Part 30) no later than the next business day after any such transaction was executed. *See* CFTC Regulation 1.33. The SEC's proposed requirement is not necessary.

No.	SEC Proposed Requirement	Existing CFTC Requirement
4	*Proposed Rule 223-1(a)(1)(i)(C).* At least annually, the qualified custodian will obtain, and provide to you a written internal control report that includes an opinion of an independent public accountant as to whether controls have been placed in operation as of a specific date, are suitably designed, and are operating effectively to meet control objectives relating to custodial services (including the safeguarding of the client assets held by that qualified custodian during the year), and *(1)* If you are the qualified custodian, or if the qualified custodian is a related person, the independent public accountant that prepares the internal control report must verify that client assets are reconciled to a custodian other than you or your related person and be registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by, the Public Company Accounting Oversight Board in accordance with its rules.	The written internal control report is redundant with several CFTC regulations. FCMs provide daily, monthly, and annual reports to the CFTC and their designated self-regulatory organizations. By noon the following business day, an FCM must submit to the CFTC and its designated self-regulatory organization a daily Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges reflecting the computation as of the close of each business day (on a currency-by-currency basis) of (1) the total amount of futures customer funds on deposit in segregated accounts on behalf of futures customers; (2) the amount of such futures customer funds required by the CEA and CFTC regulations to be on deposit in segregated accounts on behalf of such futures customers; and (3) the amount of the FCM's residual interest in such futures customer funds. It is our understanding that the CFTC conducts an independent review of these reports against its own data to identify any discrepancies. An FCM must submit to the CFTC and its designated self-regulatory organization monthly financial statements on Form 1-FR-FCM (or a FOCUS Report if the FCM is registered with the SEC as a securities broker or dealer) within 17 business days after the date for which the report is made and annual audited financial statements, certified by an independent public accountant, within 60 days of the close of the FCM's fiscal year. CFTC Regulation 1.16 requires that the independent audit referenced in CFTC Regulation 1.10 be conducted in accordance with generally accepted auditing standards and include a review and appropriate tests of the accounting system, the internal accounting control, and the procedures for safeguarding customer and firm assets in accordance with the provisions of the CEA and the regulations thereunder. Accordingly, the SEC should not require FCMs to provide internal control reports to advisers.
5	*Proposed Rule 223-1(a)(1)(i)(D).* Specifies your [the adviser's] agreed-upon level of authority to effect transactions in the account as well as any applicable terms or limitations, and permits you [the adviser] and the client to reduce that authority.	An FCM's authority is generally that of a power of attorney and may not be reduced. The SEC's proposed level-of-authority requirement is inconsistent with industry practices applicable to FCMs. For example, the CME requires trading authority that rises to the level of power of attorney over the account. To the extent that CME serves as an FCM's designated self-regulatory organization, the FCM will not be able to modify this standard to any lesser standard. Thus, the SEC's proposed requirement is not necessary.

No.	SEC Proposed Requirement	Existing CFTC Requirement
6	*Proposed Rule 223-1(a)(1)(ii)(A). Reasonable assurances obtained by adviser.* You must obtain reasonable assurances in writing from the qualified custodian (or, if you are also the qualified custodian, the written agreement required by paragraph (a)(1)(i) of this section must provide) that the custodian will comply with the following requirements, and you must maintain an ongoing reasonable belief that the custodian is complying with these requirements: (A) The qualified custodian will exercise due care in accordance with reasonable commercial standards in discharging its duty as custodian and will implement appropriate measures to safeguard client assets from theft, misuse, misappropriation, or other similar type of loss.	An FCM is subject to statutory and regulatory duties to safeguard customer assets. In addition, an FCM must have a Risk Management Program that addresses segregation risk and that includes a program to evaluate depositories of customer segregated funds and ongoing diligence of such depositories. CFTC Regulation 1.11(e)(3)(i).[37] CFTC Regulation 1.55(o)(1) requires an FCM to make its daily computation of segregation requirements and funds publicly available on its website to evidence the FCM's adherence to its segregation obligations. To the extent that an FCM does not comply with its statutory and regulatory duties, the CFTC may take enforcement action against the FCM. The risk of an enforcement action and the financial and reputational damage that could result from an enforcement action is a stronger deterrent than the Proposed Rule's written agreement requirement.
7	*Proposed Rule 223-1(a)(1)(ii)(B).* 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.	The SEC's indemnification requirement is inconsistent with industry practices. Whether a party indemnifies another party is a commercial matter between contracting parties. In addition, the CFTC prohibits an FCM from making any representation that it will, with regard to any commodity interest in any account that the FCM carries for or on behalf of any person, guarantee the person against loss, limit the person's loss, or not call or attempt to collect margin as established by the rules of the applicable board of trade.[38] When the CFTC adopted this prohibition, it stated that "the risks of the marketplace should not be obscured to the potential detriment of customers". [39] The SEC should consider these factors in any final rule and not apply the indemnification and insurance requirements to FCMs.

[37] An FCM's Risk Management Program must include "[a] process for the evaluation of depositories of segregated funds, including, at a minimum, documented criteria that any depository that will hold segregated funds, including an entity affiliated with the [FCM], must meet, including criteria addressing the depository's capitalization, creditworthiness, operational reliability, and access to liquidity. The criteria should further consider the extent to which segregated funds are concentrated with any depository or group of depositories. The criteria also should include the availability of deposit insurance and the extent of the regulation and supervision of the depository." In addition, an FCM must have "[a] program to monitor an approved depository on an ongoing basis to assess its continued satisfaction of the [FCM]'s established criteria, including a thorough due diligence review of each depository at least annually." 17 C.F.R. § 1.11(e)(3)(i)(A)-(B).

[38] 17 C.F.R. § 1.56(b).

[39] Prohibition of Guarantees Against Loss, 46 Fed. Reg. 62,841 (Dec. 29, 1981).

No.	SEC Proposed Requirement	Existing CFTC Requirement
8	*Proposed Rule 223-1(a)(1)(ii)(C).* The existence of any sub-custodial, securities depository, or other similar arrangements with regard to the client's assets will not excuse any of the qualified custodian's obligations to the client.	As noted above in Item 6, an FCM must evaluate depositories that hold customer funds and perform ongoing diligence on such depositories. In regard to the CFTC's position on an FCM holding customer funds under CFTC Regulation 30.7, only the initial depository is subject to the acknowledgment requirements imposed on FCMs, and "not to the manner in which any subsequent depository holds or subsequently transmits those funds." Appendix B to Part 30 of the CFTC's Regulations (stating, in relevant part, "The Commission notes that the initial depository's ability to identify customer funds affords foreign futures and foreign options customers a measure of protection in the event that the intermediating FMC or foreign firm becomes insolvent."). The CFTC's guidance on existing industry practices should be sufficient for FCMs to continue depositing customer funds with depositories that may use sub-custodians without incurring liability for the acts of depositories or sub-custodians.
9	*Proposed Rule 223-1(a)(1)(ii)(D).* 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.	FCMs already title customer accounts appropriately and segregate customer funds. CFTC Regulation 1.20(a) requires an FCM to "deposit futures customer funds under an account name that clearly identifies them as futures customer funds and shows that such funds are segregated as required by sections 4d(a) and 4d(b) of the Act and by this part." As such, the Proposed Rule is not necessary.
10	*Proposed Rule 223-1(a)(1)(ii)(E).* The qualified custodian will not subject client assets to any right, charge, security interest, lien, or claim in favor of the qualified custodian or its related persons or creditors, except to the extent agreed to or authorized in writing by the client.	FCMs and depositories holding customer funds already are subject to restrictions on the use of customer funds. When an FCM opens an account with a depository, the depository must agree to the terms in the CFTC-prescribed acknowledgment letter, which provides in relevant part: "You [i.e., the depository] further acknowledge and agree that the Funds in the Account(s) shall not be subject to any right of offset or lien for or on account of any indebtedness, obligations or liabilities we [i.e., the FCM] may now or in the future have owing to you. This prohibition does not affect your [i.e., the depository's] right to recover funds advanced in the form of cash transfers, lines of credit, repurchase agreements or other similar liquidity arrangements you [i.e., the depository] make in lieu of liquidating non-cash assets held in the Account(s) or in lieu of converting cash held in the Account(s) to cash in a different currency." Thus, the Proposed Rule is not necessary.

No.	SEC Proposed Requirement	Existing CFTC Requirement
11	*Proposed Rule 223-1(a)(3). Segregation of client assets.* The client's assets must: (i) Be titled or registered in the client's name or otherwise held for the benefit of that client; (ii) Not be commingled with your assets or your related persons' assets; and (iii) Not be subject to any right, charge, security interest, lien, or claim of any kind in favor of you, your related persons, or your creditors, except to the extent agreed to or authorized in writing by the client.	Section 4d of the Commodity Exchange Act requires an FCM to segregate customer funds from the FCM's own funds and any other person's funds (although an FCM may commingle customer funds held in an omnibus account). *See also* CFTC Regulations 1.20; 22.2(a), (b)(1); and 22.3(a), (b)(1). The SEC's proposed segregation requirement is not necessary.