John McCally
Senior Managing Director
General Counsel
Churchill Asset Management

8500 Andrew Carnegie Blvd
Charlotte, NC 28262
[redacted]

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

Re: Safeguarding Advisory Client Assets; Reopening of Comment Period (SEC Rel. No. IA-6384; File No. S7-04-23)

Teachers Insurance and Annuity Association of America ("TIAA") and its wholly-owned subsidiary Nuveen, LLC ("Nuveen") welcome the opportunity to submit this comment in response to the amendments proposed by the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") to its current Custody Rule (the "Proposal").[1] As General Counsel of Nuveen's affiliate Churchill Asset Management LLC, which is a leading provider of private capital investments in the U.S. middle market, I can attest to our organization's vested interest in this topic. We recognize that the SEC has concerns about the protection of client assets and the custodial protections available for privately issued securities, especially given the significant growth of the private capital markets. While we agree that appropriate steps should be taken to further enhance investor protection, we have very serious concerns about the impact of the Proposal on the commercial lending market, which we believe is less susceptible to the risks that the Commission seeks to address. In particular, our organization is concerned that the Proposal would have a detrimental impact on the ability of institutional investors to access this market through institutional separately managed accounts ("SMAs") and securitized asset funds such as collateralized loan obligations ("CLOs"). For this reason, as further discussed below, we suggest that the Commission introduce an exception to the Proposal for commercial loans or, in the alternative, a more limited exception for institutional SMAs and CLOs that invest in commercial loans.

The Custody Rule currently requires investment advisers with physical possession or the ability to obtain possession of client funds and securities to hold such funds and securities with a qualified custodian and to comply with certain other conditions intended to mitigate the risk of loss or misappropriation of client property.[2] Among other things, the Proposal would expand the scope of the rule to include within the definition of "custody" any arrangement under which the adviser has discretionary authority to purchase or sell client assets, even if such assets are not securities that are ordinarily custodied by a qualified custodian.[3] In so doing, the Proposal would

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[1] *Safeguarding Advisory Client Assets*, 17 CFR Parts 275 and 279 (February 15, 2023), *available at*: https://www.sec.gov/files/rules/proposed/2023/ia-6240.pdf.
[2] 17 CFR § 275.206(4)-2 (2010).
[3] *Safeguarding Advisory Client Assets*, 17 CFR Parts 275 and 279 (February 15, 2023), *available at*: https://www.sec.gov/files/rules/proposed/2023/ia-6240.pdf.

capture various asset classes with differing degrees of susceptibility to misappropriation and risk of loss. In the case of commercial loans issued by U.S. operating businesses (particularly those with non-investment grade ratings that are less able to access the public bond markets) ("Loans"), we believe that the risks sought to be mitigated by the Proposal are adequately mitigated by current market protocols and commercial arrangements, which were specifically designed by prudentially regulated banks that have historically dominated lending markets. Accordingly, we believe that the Commission should more carefully consider the inherent stability and long-standing protocols in the Loan market before expanding the scope of custody to Loans (particularly through institutional SMAs and CLOs), given the negative impact on institutional investors' ability to establish their own preferred custodial arrangements for these investments, and on their ability to access the market through CLOs.

Below we provide our viewpoints and recommendations as to how the SEC can modify the Proposal to produce a final rule that would be more appropriate in scope, balanced in its consideration of advisers' and investors' interests, and effective in furthering the Commission's worthy objectives. We thank the Commission for allowing us the opportunity to engage on this important topic, and we hope the perspectives offered in this letter are helpful. We note that we have reviewed the comment letter prepared by the Securities Industry and Financial Markets Association Asset Management Group ("SIFMA AMG") in response to the Proposal, and we generally agree with the concerns and arguments expressed therein with respect to CLOs and institutional SMAs that invest in the commercial loan markets.

I. **About TIAA and Nuveen.**

Founded in 1918, TIAA is the leading provider of retirement services for those in academic, research, medical, and cultural fields. Over its century-long history, TIAA's mission has always been to aid and strengthen the institutions, retirement plan participants, and retail customers we serve and to provide financial products that meet their needs. To carry out this mission, we have evolved to include a range of financial services, including retail services and the asset management services offered by Nuveen and its subsidiaries. Our investment model and long-term approach aim to benefit the more than five million individual customers and 15,000 institutions who trust TIAA and Nuveen to be careful stewards of their investments. With its strong nonprofit heritage, TIAA remains committed to our mission of serving the financial needs of those who serve the greater good. TIAA has been an active investor in the Loan market for over 20 years, having made its first leveraged loan investment in 2000, and continues to invest in this market through Nuveen and its affiliated investment advisers.

As TIAA's asset management arm, Nuveen offers a wide range of specialized investment solutions through several investment advisory affiliates. The Nuveen organization includes investment advisers that collectively manage over $1 trillion in assets, the majority of which comes from the TIAA General Account, the TIAA Variable Annuity Separate Account, and affiliated mutual fund assets. Nuveen affiliates also manage institutional SMAs, private equity funds, hedge funds, private credit funds, CLOs and other structured finance vehicles. Nuveen's leveraged finance platform is one of the industry's largest and best resourced providers of high yield credit, broadly syndicated loans, CLOs and alternative credit strategies, and Nuveen's affiliate Churchill Asset Management LLC is a leading provider of private capital investments in the U.S. middle market.

II. **The Commission Should Revise the Definition of Custody to Exclude Loans.**

We believe the Commission should exclude Loans from the scope of "custody" in the final rule, given the significant existing protections that exist in the Loan market. Prudentially regulated banks have dominated origination activity in the Loan market since its inception. Since the 2008 financial crisis, the role of non-bank lenders in the Loan market has increased, but the Loan market continues to operationally function in accordance with conventions established by commercial banks over many decades. While non-banks (including entities managed by registered investment advisers) have taken on a larger role in the Loan market, commercial banks remain heavily involved as originators of Loans, and as lenders of revolving lines and letters of credit to U.S. operating companies. Given the unique nature of the Loan market and its need to service varying types of issuers while allowing investment by numerous types of institutional investors subject to varying types of regulatory oversight, there is far less risk or misappropriation of client assets, such that an exception is warranted.

In a typical Loan transaction, a lead lender creates and maintains a loan register recording each lender's proportionate share of the relevant instrument. For several decades, holdings and transfers of interests in Loans from one lender to another have been recorded in this manner, including for regulated banks, broker-dealers, registered investment companies, business development companies and institutional investors such as life insurance companies and pension funds. While non-bank lenders have increasingly emerged in the Loan market as competitors of traditional banks in the origination and syndication of Loans (particularly in the private loan market), we note that these non-bank lenders have generally established loan administration practices modeled upon those of banks, often with support from third party administration entities and subject to additional controls established in light of staff guidance and no-action relief. Importantly, we are not aware of any significant or noteworthy cases of interests in Loans being lost or misappropriated where these market conventions were present. Accordingly, we believe the risk associated with Loans is low when compared with those arising in the more recently emergent asset classes that the Commission discusses in the Proposal.

At the same time, sophisticated institutional investors have spent decades establishing custody arrangements with regulated financial institutions pursuant to their own respective legal, regulatory and operational needs, which extend to Loans and do not require enhancement or re-negotiation to reduce the risk of misappropriation or loss. Institutional investors typically negotiate these arrangements bilaterally with their custodians in order to have consistent documentation and operational standards across asset classes that include traditional securities alongside Loans. Few (if any) institutional investors seek to negotiate tripartite custody agreements that include their investment advisers, given the desire to remain legally and operationally independent of their service providers. This gives such investors greater ability to negotiate with their advisers, who must compete both on the pricing of their services and their ability to meet the operational requirements of their institutional investor clientele.

While we appreciate the Commission's concern regarding emergent asset classes where current operational and custodial systems may not currently address certain risks, we believe that the maturity and stability of the Loan market calls for an exception, particularly because the Proposal would interfere with the ability of institutional investors (investing through institutional SMAs and CLOs) to negotiate their own arrangements for their Loan investments. As a result, we suggest that the Commission consider an exception for traditional commercial loans (including leveraged loans) from the scope of custody generally.

III. Alternatively, the Commission Should Provide an Exception for Institutional SMAs and CLOs Predominantly Invested in Loans.

Should the Commission decide not to generally exclude Loans from the Proposal, the Commission should at least exclude CLOs and institutional SMAs investing in Loans, given their unique structures and longstanding market practices.

As the Commission is aware, Loans are a form of "non-DVP" asset that are not able to be settled on a delivery-versus-payment basis. However, unlike some of the emergent asset classes that the Commission discusses in the Proposal, Loans are subject to longstanding, tested market practices for recordation and transfer that originated with prudentially regulated financial institutions, as we discuss further above. If those longstanding practices are insufficient in the Commission's view to warrant an asset-specific exclusion, then we suggest in the alternative that the Commission consider a more limited exception for certain institutional investment vehicles that commonly invest in Loans which pose the least risk of loss or misappropriation (e.g., institutional SMAs and CLOs).

As discussed above, institutional SMAs that hold Loans are typically established by institutional investors that are investing on their own balance sheets in a wide array of asset classes and seeking an adviser to manage such investor's allocation to Loans. Institutional investors require investment advisers to compete for the opportunity to manage such investors' allocation to Loans, and often require advisers to adhere to existing custodial and operational procedures that the investor has established bilaterally with its custodian. Many of these investors have also entered into separate servicing agreements with respect to Loans, which may be performed by an affiliate of the custodian or by a third-party financial entity, specifically for the needs of such institutional investor (e.g., cash and portfolio reconciliation services). By requiring such investors to negotiate tripartite arrangements with their advisers and custodians in respect of these agreements, the Proposal would impair investor flexibility and discretion in managing their own service provider contracts and investment assets.

While we appreciate the Commission's attempt to limit the impact of the surprise exam requirement to institutional SMAs via the expansion of the audit exception, we do not believe the audit exception is well-suited to institutional SMAs. Institutional investors may be U.S. or non-U.S. persons subject to varying types of financial reporting, and their annual audits are conducted pursuant to those distinct requirements. The various conditions to the SEC's annual audit exception would not be capable of being satisfied for a great number of institutional investors, who conduct their annual audits pursuant to their own regulatory and financial reporting regimes. As a result, we believe that the extension of the audit exception to these types of investors would offer relief in name only, leaving advisers with no choice but to satisfy a surprise exam requirement that will result in little appreciable benefit, given the high degree of control that institutional investors exercise over their non-DVP investment portfolios and over the *bilateral* negotiations they engage in with their custodians and advisers, respectively.

In the case of CLOs, we believe the Proposal does not consider the significant legal and operational controls in place for such structures and conflicts with the Commission's own approach to securitized asset funds in the recent Private Fund Advisers Final Rule. First, the proposed requirement to require CLOs to directly contract with a qualified custodian deviates from current CLO market practice. The Proposal would require CLO managers to either enter into new custody agreements with qualified custodians or become parties to the standard account control agreements that are traditionally bilateral agreements between a trustee affiliate and the CLO issuer. Mandating advisers and custodians to engage in commercial negotiations over asset classes where such negotiations have never occurred before, with no evidence of prior misappropriation in those markets, will not only harm the CLO market, but also investors, as both options would result in increased costs for CLOs that would be passed down to investors.

Second, we note that the same institution that serves as the CLO's indenture trustee (holding title to the Loans forming the asset base of the CLO) also acts as its custodian and, as a bank, is a "qualified custodian." CLO cash and collateral accounts are also subject to account control agreements that require all securities and other property delivered to the CLO to be credited to the appropriate custodial account, which is subject to a perfected security interest. While CLOs are not subject to annual audit, this is precisely due to expressed investor interest in avoiding the performance of an expensive and time-consuming audit that would be duplicative of the significant protections already in place in these vehicles. These protections include regular reporting and oversight by the trustee and an independent board of directors, with CLO investors receiving reports that include information related to loans and cash held by the CLO, including a monthly report detailing the loans held and payments made and received in accordance with the CLO indenture, and a quarterly distribution report disclosing payments made in accordance with the waterfall described in the CLO indenture. In addition, a third-party collateral administrator performs administrative duties on behalf of the CLO with respect to its assets (e.g., cash and portfolio reconciliation), providing an additional independent check on the manager of the CLO.

Lastly, with respect to the application of financial audits to CLOs, we believe that these aforementioned protections are among the reasons that the Commission allowed an exception from the audit requirement in the Private Fund Advisers Rule for securitized asset funds. We agree with the statements made by the Commission in the final adopting release for the Private Fund Advisers Rule regarding the application of the audit requirement to these investment products and believe that those statements extend with equal relevance to this matter. While we understand that the specific objectives of the Safeguarding Rule are not identical to the Private Fund Advisers Rule, we nevertheless believe that re-introducing an audited financial statement requirement via the Safeguarding Rule would constitute an arbitrary result for these investment products, given the lack of any appreciable benefit to such an audit, and would undermine the need for regulatory clarity and consistency.

Because CLOs and institutional SMAs investing in Loans have unique structures that afford these investors with significant protections, and given the lack of evidence of misappropriation of Loans in these products, it begs the question whether the Proposal is adequately tailored to the purpose of protecting investors. Therefore, we urge the Commission to exclude these products from the Proposal, or at a minimum from the surprise audit and triparty custodial agreement conditions.

IV. **Conclusion.**

While we appreciate the SEC's endeavors to devise considerate solutions for enhancing investor protection, in our view the proposed remedy in the Proposal would prove considerably more detrimental to institutional investors in the commercial lending market. Should the Commission decide to move forward with the Proposal and not exclude Loans generally (or to proceed with the Proposal but not exclude CLOs and institutional SMAs), we urge the SEC to at least exclude CLOs and institutional SMAs from the audit verification and triparty custodial agreement requirements. Particularly with respect to institutional investors accessing the Loan market through SMAs, we believe that the obligation to enter into triparty custody agreements among an asset owner, its custodian, and its adviser would impose inappropriate obligations on institutional investors not subject to SEC regulation and would force such parties to engage in negotiations inconsistent with longstanding practice. As it relates to the audit exception, the extension of the exception to these otherwise-regulated institutions appears to offer nothing more than false hope for advisers that ultimately will be unable to rely on such exception.

We agree with SIFMA AMG's assessment that the Proposal, as written, appears to indirectly regulate the business of custodians. We believe this assessment extends to institutional investors as well. The Proposal would not only indirectly regulate custodians that are subject to adequate banking regulation by prudential regulators, but would also indirectly regulate state-regulated insurance companies, pension plans, foreign special purpose companies (CLOs) and other institutional investors outside of the SEC's jurisdiction. Each of these entities currently negotiate their own custody agreements for their Loan assets. We agree with SIFMA AMG's assessment that "imposing requirements of business terms, segregation, standards of conduct, and insurance requirements on custodians has nothing to do with the acts and advice of the adviser," and its recommendation to the SEC – to avoid potential litigation due to the question of jurisdictional authority – to work with the appropriate regulators if the SEC believes custodian reform is necessary.

As noted above, we are willing and eager to help find ways to address the Commission's concerns. However, we believe the requirements set forth in the Proposal are overbroad and that a more carefully tailored solution should be considered. We strongly urge the SEC to consider the many consequences of its suggested approach, and to embark upon a more careful and considered path to addressing what we agree are valid concerns. We hope the comments we have provided herein are helpful as the SEC determines its next steps, and we would welcome further engagement with the Commission on this topic.

Sincerely,

John McCally

John McCally