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

Submitted via email (rule-comments@sec.gov)

Re: Proposed Rules and Rule Amendments Regarding Safeguarding Advisory Client Assets [Release No. IA-6240; File No. S7-04-23]

Dear Ms. Countryman:

This letter is submitted by Akin Gump Strauss Hauer & Feld LLP, an international law firm with a significant investment management practice that, among other things, represents registered investment advisers, exempt reporting advisers and other entities that advise and manage private funds.

This comment letter provides certain comments and views regarding the impact that proposed Rule 223-1 and proposed amendments to Rules 206(4)-2 and 204-2 and Form ADV (collectively, the "Proposal"), which were proposed by the U.S. Securities and Exchange Commission (the "Commission") in Investment Advisers Act Release No. IA-6240[1] (the "Proposing Release"), would have on investment advisers and their clients. For the sake of clarity, we point out that this comment letter represents the views of members of the firm who advise private funds and is not intended to reflect the views of any particular firm client or group of clients.

We appreciate the Commission providing us the ability to provide comments on the Proposal and recognize the time and effort invested by the Commission and the Staff of the Division of Investment Management (the "Staff") in formulating the Proposal and in the drafting the Proposing Release.

COMMENTS, CONCERNS and SUGGESTIONS

Although we agree with the Commission that it is important for advisers to ensure that client assets are properly maintained, we share and echo many of the concerns that have been raised in numerous comment letters submitted to the Commission by various industry and trade organizations. In the interest of brevity, we will not reiterate those comments here.

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[1] Safeguarding Advisory Client Assets, SEC Release No. IA-6240; File No. S7-04-23 (February 15,2023), *available at* https://www.sec.gov/rules/proposed/2023/ia-6240.pdf.

Rather, we want to focus on one element of the Proposal that is of particular interest to our client base: the proposed enhancements to the definition of "Foreign Financial Institution" (FFI).

The Current Regime Is Effective and Flexible

Our fund manager clients often trade on a global basis, frequently investing on behalf of their advisory clients in various asset classes in numerous non-U.S. markets. This global trading benefits those clients by providing them exposure to those non-U.S. markets and instruments. In fact, one value that private fund managers bring to the financial system is the flexibility and the ability to access markets other than the traditional major global financial centers (*e.g.*, New York, London, Singapore and Hong Kong).[2]

An investment adviser that trades on a foreign exchange often must maintain client assets with an FFI in the relevant market. In order for an FFI to be deemed a "qualified custodian" under the current Custody Rule, that FFI must satisfy three conditions:

- It must be a "foreign financial institution" (this is an undefined descriptor in the current Custody Rule);
- It must "customarily hold financial assets for its customers"; and
- It needs to maintain the advisory client's assets in a customer account segregated from its proprietary assets.[3]

The current system has all the hallmarks of good regulation: it is straightforward, understandable, comprehensive and effective.

And, it has worked quite well. The Proposing Release does not cite any risks or failures by FFIs under the existing Custody Rule. Further, any concerns that the Commission has expressed in the past with respect to FFIs have been centered not around issues with respect to custody of advisory client assets but rather with non-custody issues such as anti-money laundering.[4]

The Proposal, however, would eliminate the current segregated account requirement and instead impose seven new conditions that an FFI would be required to satisfy in order to serve as a qualified

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[2] See Global Financial Centres Index, March 23, 2023, available at https://www.longfinance.net/media/documents/GFCI_33_Report_2023.03.23_v1.1.pdf (GFCI 33). According to the GFCI 33, which ranks the top 120 financial centers around the world, New York, London, Singapore and Hong Kong, respectively, comprise the top four global financial centers.

[3] See Rule 206(4)-2(d)(6)(iv).

[4] See *e.g.* SEC Staff Bulletin: Risks Associated with Omnibus Accounts Transacting in Low-Priced Securities, November 12, 2020, *available at* https://www.sec.gov/tm/risks-omnibus-accounts-transacting-low-priced-securities; and Policy Statement on Obtaining and Retaining Beneficial Ownership Information for Anti-Money Laundering Purposes, SEC Release No. 34-61651, March 5, 2010, *available at* https://www.sec.gov/rules/other/2010/34-61651.pdf.

custodian.[5] We have serious concerns with these new conditions and the implications they will have on the potential pool of FFIs available to private fund advisers.

The New FFI Conditions Are Uncertain, Subjective and Overly Restrictive

The definition of "qualified custodian" in the Safeguarding Rule Proposal uses a mix of categorical and absolute language when defining an FFI. Such language is appropriate for objectively verifiable things, such as whether the FFI is incorporated or organized under the laws of a country other than the United States[6] or is regulated by a non-U.S. government as a banking institution, trust company or other financial institution that customarily holds customer assets.[7]

This language is less appropriate, however, when qualitative, subjective determinations are similarly phrased in absolute terms. The most concerning of those subjective determinations is the requirement that an FFI have "the requisite financial strength to provide due care for client assets."[8] Although the Staff has stated that they "believe the determination of an FFI's financial strength could be based on objective measures and other indicators of financial health that are reasonably comparable to those that apply to U.S. banks and other regulated financial institutions,"[9] this proposed condition is an inherently subjective standard presented as an absolute requirement.

This "requisite financial strength" requirement is also being imposed on an adviser without any qualifications, such as requiring that the adviser have a reasonable belief that the FFI has the requisite financial strength or phrasing the requirement that the adviser make the determination that the FFI has the requisite financial strength after conducting reasonable due diligence.

As a result, this ambiguous standard lends itself to second-guessing. Advisers will find themselves questioned as to whether the standards on which they have based their determinations were appropriate. While the Staff notes in the Proposing Release that advisers "would be required to maintain an ongoing reasonable belief that the FFI qualified custodian is meeting its due care standard," we are concerned that the actual standard could be strict liability.

We would point out that a number of U.S. and European banks that no longer exist as going concerns would have been universally deemed to possess "requisite financial strength" six months or even 90 days prior to intervention by the relevant regulator. Therefore, we worry that advisers, no matter how

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[5] As noted in the Proposing Release, the Commission has proposed eliminating the requirement that the FFI keep advisory client assets in customer accounts segregated from its proprietary assets because proposed Rule 223-1(a)(1)(ii)(D) would require advisers to obtain reasonable assurances from qualified custodians – not only FFIs – that all advisory client assets are segregated from the qualified custodian's proprietary assets and liabilities. See Proposing Release, n. 98.

[6] See Proposed Rule 233-1(d)(10)(iv)(A).

[7] See Proposed Rule 233-1(d)(10)(iv)(B).

[8] See Proposed Rule 233-1(d)(10)(iv)(E).

[9] See Proposing Release, at 51.

much initial and ongoing due diligence is conducted on an FFI, could face a Safeguarding Rule violation for any failure of a custodian FFI.

Conditions Improperly Extend U.S.-Centric Standards to Non-U.S. Markets

Other conditions that would be imposed on FFIs under the Proposal are very U.S.-centric and do not necessarily translate to every asset class in every financial market in every country in the world. For example, the Proposal would impose a requirement that, for an FFI to be a qualified custodian, the adviser and the Commission must be "able to enforce judgments, including civil monetary penalties, against" the FFI.[10] As we all know, legal standards, processes and outcomes vary in many non-U.S. markets. We fear that an insistence on Anglo-American concepts of jurisdiction and civil procedure may effectively eliminate the ability of advisers to invest in developing or other non-U.S. markets. We would posit that the Commission instead focus on requiring effective and thorough disclosure of the risks (including custody risks) attendant to investments in non-U.S. geographies, sectors, and products.[11]

The Proposal, also operates to extend U.S. laws and standards onto other markets. For example, one proposed condition would require the FFI to be "required by law to comply with anti-money laundering and related provisions similar to those of the Bank Secrecy Act and regulations thereunder." [12] Another would impose a requirement that FFI qualified custodians be "required by law to implement practices, procedures, and internal controls designed to ensure the exercise of due care with respect to the safekeeping of client assets."[13] In the Proposing Release, the Staff expressed their belief that "this condition would help promote a minimum level of practices, procedures, and internal controls across qualified custodians for safekeeping client assets under the proposed rule, regardless of where and how they are held."[14] This requirement also embodies the Commission's desire that the custody practices of FFIs be materially identical to the Commission's own requirements.[15] Again, we see this as being an effective bar to investments in certain areas and would endorse a fulsome disclosure requirement instead.

Proposal Will Increase Costs to FFIs, Advisers and Clients

The imposition of the various requirements on FFIs will increase the costs to FFIs. Even if an FFI is able to meet the burdens imposed by the Proposal, it will likely incur costs in doing so, which costs will

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[10] See Proposed Rule 233-1(d)(10)(iv)(A).

[11] See Proposing Release, p. 48.

[12] See Proposed Rule 233-1(d)(10)(iv)(C). As another example, the Proposing Release states "while functional regulators have not defined possession or control in the custody context in a manner identical to our proposed rule . . . we view the proposed definition to be crucial to safeguarding client assets. . . ."

[13] See Proposed Rule 233-1(d)(10)(iv)(F).

[14] See Proposing Release, p. 51.

[15] *Id.* at 51. Specifically, the Proposing Release states, "Further, we believe this requirement will help to ensure that an FFI's practices, procedures, and internal controls, including, but not limited to, those with respect to the safekeeping of certificated and uncertificated assets, custodial recordkeeping, and security and data protection, **should not differ in material ways from those of U.S.-regulated custodians**." (emphasis added)

likely be passed on to clients. [16] The industry will also suffer from the loss of competition, as non-U.S. custodians exit the market by refusing to service U.S. advisory clients – in some cases, leaving whole markets without any custodians available to U.S. advisers. We worry about triggering these effects without, in our opinion, enough data on how many client accounts or assets would actually be affected by this aspect of the Proposal.[17]

CONCLUSION

The practical effect of the Proposal would be to create barriers to entry to advisers in numerous markets – particularly smaller markets – thereby effectively banning trading in those markets and increasing costs in markets where a smaller number of FFIs elect to remain as eligible custodians under the Safeguarding Rule.

We would close by again thanking the Commission and the Staff for their strenuous and serious efforts to protect clients and the investing public, and for doing so in a transparent and responsible manner.

We would be pleased to respond to any inquiries you may have regarding our letter or our views on the Proposal more generally. Please feel free to direct any inquiries to Brian Daly at +1 212.872.8170 or at bdaly@akingump.com.

Very Truly Yours,

AKIN GUMP STRAUSS HAUER & FELD LLP

[16] *Id.* at 283.

[17] *Id.* at n. 489.