

Proposed Safeguarding Rule



The Securities and Exchange Commission proposed to exercise its authority under section 411 of the Dodd-Frank Wall Street Reform and Consumer Protection Act by amending and redesignating rule 206(4)-2 under the Investment Advisers Act of 1940 (“Advisers Act”) to enhance investor protections relating to advisory client assets. The proposed amendments would:

- Expand the current custody rule to protect a broader array of client assets and advisory activities to the rule’s protections;
- Enhance the custodial protections that client assets receive under the rule; and
- Update related recordkeeping and reporting requirements for advisers.

Why This Matters

Since its initial adoption in 1962, Rule 206(4)-2 under the Advisers Act (the “current custody rule”) has required investment advisers to safeguard client funds and securities in their possession or where they have authority to obtain possession of them. The rule is designed to protect these assets from the adviser’s own insolvency or bankruptcy, and from the assets being lost, misused, stolen, or misappropriated.

Since the current custody rule was last amended in 2009, changes in technology, advisory services, and custodial practices have created new and different ways for client assets to be placed at risk of loss. In addition, in 2010, Congress gave the Commission more expansive and explicit authority to protect client assets. Thus, the proposal would scope in certain other assets that do not receive custodial protections under the current custody rule.

The proposed amendments would strengthen the rule’s protections to address these developments. The amendments would also redesignate the current custody rule as new rule 223-1 under the Advisers Act (the “safeguarding rule”). Complementary changes to the Advisers Act books and records rule and Form ADV are designed to align reporting obligations with the proposed rule and to improve the accuracy of custody-related data available to the Commission, its staff, and the public.

Proposed Amendments

The proposed amendments would expand the scope of the current custody rule beyond client funds and securities to include any client assets of which an adviser has custody. This proposed change uses the more expansive and explicit language employed by Congress in empowering the Commission to develop rules to protect client assets when advisers have custody. “Assets” would mean “funds, securities, or other positions held in a client’s account”

and would include all other assets that investment advisers custody for their clients. The safeguarding rule would also explicitly include an adviser's discretionary authority to trade client assets within the definition of custody.

Like the current custody rule, the safeguarding rule would require advisers with custody of client assets to maintain those assets with a qualified custodian, with very limited exceptions. A qualified custodian generally is a federal or state-chartered bank or savings association, certain trust companies, a registered broker-dealer, a registered futures commission merchant, or certain foreign financial institutions ("FFI"). Under the proposal, a qualified custodian would be required to have "possession or control" of advisory client assets. The proposal would require a more robust set of requirements for an institution to be an FFI that is eligible to serve as a qualified custodian. The proposal would also further specify the manner in which qualified custodian banks and savings associations must hold client assets.

The proposed safeguarding rule's enhanced protections would also:

- Require that an adviser enter into a written agreement with and obtain certain reasonable assurances from qualified custodians to ensure clients receive certain standard custodial protections when an adviser has custody of their assets. These protections are designed, among other things, to ensure client assets are properly segregated and held in accounts designed to protect the assets in the event of a qualified custodian bankruptcy or other insolvency;
- Modify the current custody rule's exception from the obligation to maintain client assets with a qualified custodian for certain privately offered securities, including expanding the exception to include certain physical assets;
- Retain the current custody rule's requirement for an adviser to undergo a surprise examination by an independent public accountant to verify client assets, but expand the availability of the current custody rule's audit provision as a means of satisfying the surprise examination requirement;
- Amend the investment adviser recordkeeping rule to require advisers to keep additional, more detailed records of trade and transaction activity and position information for each client account of which it has custody; and
- Amend Form ADV to align advisers' reporting obligations with the proposed safeguarding rule's requirements and to improve the accuracy of custody-related data available to the Commission, its staff, and the public.

Additional Information:

Visit [sec.gov](https://www.sec.gov) to find more information about the proposal and the full text of the proposed rules. The comment period will be open for 60 days following publication of the proposing release in the Federal Register.