May 8, 2023

Vanessa A. Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street
NE Washington, DC 20549-1090
VIA ELECTRONIC MAIL: rule-comments@sec.gov

Re: File No. S7-04-23
Proposed Rule on Safeguarding Advisory Client Assets

Dear Ms. Countryman:

We are responding to the request for comments from the Securities and Exchange Commission (the "Commission") about the recently proposed rule (the "Proposed Rule") that addresses how investment advisers safeguard client assets under the Investment Advisers Act of 1940 (the "Advisers Act").

RIA Lawyers LLC is a law firm that was founded in January 2022 and has four lawyers located throughout New Jersey, Pennsylvania, and Ohio. Before founding RIA Lawyers LLC, our attorneys practiced law and gained compliance experience in-house at a self-regulatory organization, at a Fortune 500 financial services company, at an independent investment adviser managing several billions of dollars in capital, at a top 10 AMLaw global law firm, and at a large regional law firm. These comments, while informed by our experience representing our clients, represent our own views and are not intended to reflect the views of any particular investment adviser that we represent.

We applaud the Commission's efforts to modernize Rule 206(4)-2 and its desire to better safeguard investment advisers' clients' assets, which we believe are two important goals. We also recognize the time and effort invested by the Commission and the Staff of the Division of Investment Management (the "Staff") to formulate the Proposed Rule, especially considering the recent challenges presented in the digital asset space. Nonetheless, we believe the Commission could strike a much better balance of protecting investors without unduly burdening smaller investment advisers and stifling business competition in the financial services sector.

The Proposed Rule will significantly impact our clients, and in many respects, not for the better. We almost exclusively represent registered and unregistered investment advisers who include, among others: (i) traditional wealth managers that are registered with the Commission as investment advisers, (ii) multifamily offices, (iii) fintech companies that provide investment-related services to registered investment advisers, and (iv) registered and unregistered private investment fund managers. Some of our traditional wealth management clients also advise on and invest client assets in digital assets. Without performing any significant analysis, we estimate our typical clients manage between $300 million and $3 billion in "regulatory assets under management".

I. Congress Did Not Contemplate Redefining "Custody" to Include "Discretionary Authority"

a. The Commission Does Not Have the Authority Under Dodd Frank

First, we share our concerns that the Commission does not have the authority to promulgate such broad and sweeping revisions to the definition of "custody". In the Proposing Release[1], the Commission cites to the addition of Section 223 of the Advisers Act by the Dodd-Frank Wall Street Reform and Consumer Protection Act as authority

[1] *See* Safeguarding Advisory Client Assets, Release No. IA-6240 (Feb. 15, 2023)(the "Proposing Release").

for its rulemaking authority to expand the term "custody".[2] Section 223 of the Advisers Act provides the Commission with the authority to prescribe rules for investment advisers to "take such steps to safeguard client assets over which such adviser has custody…."

Dodd Frank did not authorize Congress to revisit its definition of custody, but instead instructed Congress to promulgate rules to "safeguard client assets over which such adviser has custody". We believe that the expansion of the definition of "custody" to include "discretionary authority" would greatly exceed the rulemaking authority contemplated by Congress in Dodd Frank.

According to the Fixed-Meaning Canon of judicial construction[3], words must be given the meaning they had when the text was adopted. At the time of passage of Dodd Frank, the term "custody" was already a defined term and had a generally accepted meaning. The term "custody" was fairly crystallized by 2003. At the time of the adoption of Dodd Frank in mid-2010, both the Commission and Congress understood the definition of "custody" for purposes of the Advisers Act. That understanding did not include discretionary trading authority.

Therefore, by expanding the definition of "custody" to include discretionary trading authority, we believe the Commission would be exceeding its authority granted by Congress in Dodd Frank.

b. The Commission Does Not Have the Authority Under Section 211(a)

Section 211 of the Advisers Act states, "The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders *as are necessary or appropriate to the exercise of the functions and powers conferred upon the Commission* elsewhere in [the Advisers Act]…" (emphasis added).

We do not believe the Commission has the broad authority under Section 211(a) of the Advisers Act to redefine "custody" to include discretionary trading authority, because it is not necessary or appropriate to the exercise of the functions and powers conferred upon the Commission elsewhere under the Advisers Act. The substantive, enumerated functions and powers of the Commission in the Advisers Act generally relate to i) the registration of investment advisers, ii) recordkeeping and reporting by investment advisers, iii) examination of those records, iv) policies and procedures to protect material, nonpublic information, v) prohibitions in investment advisory contracts, and vi) enumerated prohibited transactions regarding fraudulent and deceptive practices. We are not aware of any functions or powers conferred upon the Commission relating to the type of trading authority granted to an investment adviser. As we explain below, we do not believe that the inclusion of discretionary trading authority in the definition of "custody" serves any meaningful antifraud purpose. For these reasons, we believe that the plain meaning of Section 211 is unambiguous, and the Commission does not have the authority to promulgate the Proposed Rule in its current form.

Moreover, as noted in in Section I.a above, we believe that Congress's adoption of Section 223 amounted to Congressional adoption or tacit approval of the current definition of "custody." Congress had an opportunity to redefine the definition of "custody", but instead opted to provide the Commission with additional rulemaking authority to "safeguard client assets over which such adviser has custody." We believe that any expansion of the term would frustrate Congress's legislative intent and exceeds the Commission's authority.

If the Commission proceeds with adopting a final rule for safeguarding advisory client assets, we respectfully request the Commission to abandon its effort to expand the current definition of "custody" or provide an explanation for why the Commission believes it has the authority to expand the definition considering the limited instruction provided by Dodd Frank and Section 211(a)'s limitations.

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[2] *See* Section 411 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
[3] *See* A. Scalia & B. Garner, Reading Law: The Interpretation of Legal Texts (2012).

II. There is Insufficient Justification to Treat Discretionary Authority and Non-Discretionary Authority Differently Under the Proposed Rule

We believe there is insufficient justification for the Proposed Rule to treat discretionary trading authority and non-discretionary trading authority differently, and that such disparate treatment will not serve to protect client assets from fraud. This disparate treatment is less than ideal from a policy perspective and is likely "arbitrary and capricious"[4].

Typically, the relationship between an investment adviser and a client is nearly identical in all material respects whether an investment maintains discretionary or non-discretionary trading authority. In our experience, the primary (and likely sole) difference between the two relationships for most investment advisers is that an investment adviser will seek approval from a client before executing each trade or taking a course of action in a non-discretionary relationship. In contrast, an investment adviser who manages client assets on a discretionary basis commonly establishes investment objectives with the client and then manages the accounts accordingly until the client directs otherwise. The level of trading authority granted to an investment adviser does not provide an observer with any other facts about the relationship between adviser and client.

If the Proposed Rule is adopted in its current form, it would likely incentivize investment advisers to manage client assets strictly on a non-discretionary basis, to the detriment of their clients and the marketplace in general. As a practical matter, non-discretionary management of clients is a minority practice amongst our clients. Those investment advisers that manage assets on a non-discretionary basis typically do so as accommodation or for more sophisticated clients. We believe our clients and their clients find the practice inefficient. Non-discretionary engagements are limiting because clients are not always available while their investment adviser is available to discuss a proposed transaction for their account.

Because fraud could just as easily transpire in a non-discretionary account as it would for a discretionary account, we don't quite appreciate how the absence of an investment adviser communicating with a client prior to trading or taking a course of action justifies the imposition of burdensome and expensive regulatory requirements. More critically, we do not believe that the additional measures under the Proposed Rule will serve to prevent fraud and theft, which as we outlined above, the custody rule and Section 223 of the Advisers Act were designed to prevent.

For contrast, FINRA rules generally require registered representatives to obtain consent prior to the execution of transactions for customers. In its most recent statistics reported on its website, FINRA referred 758 matters for fraud for prosecution and barred 655 individuals.[5] Fraudulent activities still happen regardless of the authority conferred by clients on an investment adviser and will likely continue to happen if the Commission expands its definition of custody to include discretionary trading authority.

We believe including discretionary authority in the definition of custody will have minimal impact on preventing fraud and safekeeping assets and will impose substantial time, energy, and financial costs on investment advisers, as further discussed below.

III. Small Investment Advisers Have Unique Business Practices That Should Not Effectively Be Banned

We believe that the prior custody rule struck an appropriate balance in allowing small investment advisers to engage in business practices that allowed them to set themselves apart from larger investment advisers without imposing unnecessary costs while investors and their assets remained sufficiently protected. These practices include where: (i) an investment adviser or one of its employees serves as executor, trustee, or in a comparable capacity for a client; (ii) an investment adviser or an affiliate (typically an accounting firm) accepts check-writing or bill-paying authority

[4] *See* Chevron v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984)..
[5] *See* FINRA 2021 Statistics, available at https://www.finra.org/media-center/statistics.

on behalf of a client; or (iii) an investment adviser accepts login credentials to a retirement plan account, brokerage account, or other type of investment account so that the investment adviser can provide ongoing supervision and management over these "held away" assets.

In each of these cases, the investment adviser would be required to maintain the assets subject to these arrangements with a qualified custodian and, in most cases, engage an independent public accountant to perform a surprise examination of the assets.

The written agreement requirement imposed by proposed Rule 223-1(a)(1)(i) would be extremely difficult, if not impossible for investment advisers—let alone smaller investment advisers—to comply with. In most instances, the investment advisers do not have any business relationship with the qualified custodian. Typically, the client has selected a bank, trust company, or broker-dealer to hold the client's assets without the assistance of the investment adviser. These qualified custodians have little to no incentive to enter into a written agreement with the smaller investment adviser. In fact, these qualified custodians often have investment advisers, banks, or trust companies that compete with these smaller investment advisers. Even if these qualified custodians were somehow inclined to cooperate with the investment adviser for the benefit of their customers, it is unlikely that they will agree to each of the requirements of proposed Rule 223-1(a)(1). We believe that these requirements will disproportionately impact smaller investment advisers that offer their clients these additional services.

We acknowledge the current custody rule limits independent verification to only those accounts that the investment adviser has reported to the accountant as being subject to the custody rule. Nonetheless, we believe that the current rule strikes an appropriate balance. In our experience, investment advisers and their supervised persons who are not engaged in fraud maintain accurate lists of these accounts and assets and report these assets to the accountant for examination. If the Commission believes additional safeguards are required to protect investors, it should explore ways to ensure that investment advisers who are relying on surprise examinations to comply with the custody rule are maintaining and producing accurate lists of accounts over which they are deemed to have custody to their accountant. For example, the final rule could require the accountants conducting the independent verifications to audit the selection process itself or possess some level of confidence that the appropriate clients and accounts have been delivered to them.

IV. The Written Agreement Requirement Will Result in Anticompetitive Outcomes

We believe that the written agreement requirement imposed by the Proposed Rule would drastically reduce competition amongst qualified custodians for investment advisers, create an additional bar for future entrants, unnecessarily protect incumbents, and result in increased costs for investors.

Proposed Rule 223-1(a)(1)(i) would require investment advisers to take certain steps to safeguard client assets over which they have custody. One of those steps would require investment advisers to enter into a written agreement with and receive certain assurances from the qualified custodian to ensure the qualified custodian provides certain custodial protections when maintaining client assets. Many of these assurances would impose new and costly measures on qualified custodians. To comply, a custodian would need to allocate substantial resources to drafting and negotiating the written agreements and build out their operational processes to ensure they are meeting these contractual commitments. This would create a significant burden, particularly for smaller or newer qualified custodians who may not have the resources to undertake this process, which will likely result in fewer qualified custodians that are able to serve investment advisers and their clients.

This proposal comes at a time when investment advisers are already impacted by a lack of qualified custodial options due to the recent merger between Schwab and TD Ameritrade. Based on our communications with clients who receive those services, the consensus is that reduced competition will likely lead to higher costs for investment advisers and their clients. Moreover, the new proposed requirements favor larger, more established custodians who have the resources to comply, thus further reducing competition amongst qualified custodians. Smaller and newer custodians, who may be better suited to meet the needs of certain investment advisers and their clients, may be

effectively shut out of the market.

In conclusion, while the written agreement requirement imposed by proposed Rule 223-1(a)(1)(i) may seem like a reasonable safeguard, it will likely have the unintended consequence of drastically reducing competition amongst qualified custodians for investment advisers.

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Thank you for giving us the opportunity to comment on the Commission's proposed rule to address how investment advisers safeguard client assets under the Advisers Act. We are uniquely positioned as a voice of smaller and mid-sized investment advisers and would be happy to meet with the Commission or its staff to discuss any of our comments or provide further feedback.

Yours truly,

RIA Lawyers LLC
Max Schatzow, Esq., Ryan Walter, Esq., and Cary Kvitka, Esq.