CITADEL

August 11, 2023

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

Re: Safeguarding Advisory Client Assets (File No. S7-18-21)

Dear Ms. Countryman:

We appreciate the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") in response to the Commission's proposed new Rule 223-1 (the "Proposal"), which would replace current Rule 206(4)-2 (the "Custody Rule").[1]

Citadel is a leading investor in the world's financial markets, managing nearly $60 billion in investment capital on behalf of a diverse array of investors, including pensions (local, corporate, and union), endowments, healthcare providers, foundations, and insurance companies. Founded in 1990, our flagship fund has delivered a 19.7% annualized return since inception, returns that help our investors fund innovative research, support leading academic institutions, and secure the retirement futures of their beneficiaries. The strong partnership with our investors is exemplified by the fact that our 15 largest investors have entrusted us with their capital for approximately 13 years on average.

The Proposal would disrupt the proper functioning of a wide range of critical financial and commodities markets both in the U.S. and internationally, including the futures, OTC derivatives, physical commodities, repo/reverse repo, and securities lending markets, to name a few. Without any apparent thoughtful review of these drastic implications, with the stroke of the pen the Commission has proposed to apply the current safekeeping regime for *securities* to *every other asset class* globally. However, many of the asset classes and services affected by the Proposal are (i) already subject to comprehensive regulation by other regulatory frameworks that have evolved over decades or longer, and (ii) are not compatible with the securities safekeeping regime. In proposing such a radical departure from well-established practices, the Commission failed to analyze whether its Proposal was compatible with the custody and trading practices of a myriad of different types of assets, failed to consider existing regulatory frameworks, and failed to examine the costs its approach would impose on investors, investment advisers, and the vast number of financial and commodities markets it would impact.

The Proposal would generally require qualified custodians to segregate an advisory client's (i.e., fund's) assets. This, in turn, would effectively prevent funds from accessing standard prime brokerage services and banking services. In doing so, the Commission contradicts its own customer protection framework under Section 15c3-3 of the Securities Exchange Act of 1934 ("Exchange Act"), which permits desegregation and rehypothecation of margin securities. Margin

[1] Safeguarding Advisory Client Assets, 88 Fed. Reg. 14672 (Mar. 9, 2023).

financing by broker-dealers is an important funding source widely used by advisers on behalf of their clients, and effectively prohibiting rehypothecation in this manner will either make this financing unavailable or significantly increase the fees and rates charged by broker-dealers to clients for prime brokerage services, negatively impacting investor returns.

By proposing to mandate segregation of all margin exchanged in connection with uncleared OTC derivatives, the Commission would override decades of policymaking by other financial regulators[2] and the SEC itself.[3] Requiring the segregation of all excess and variation margin would have significant implications for a myriad of fund investment, trading and risk management activities. It would also significantly increase the costs of transacting in these instruments and result in less favorable pricing for advisory clients. Advisory clients would experience a reduction in swap counterparties willing to trade, resulting in more concentrated credit risk, and the inability to efficiently or effectively carry out their risk management programs.

The Proposal sets forth an unworkable alternative custody framework for physical assets and privately offered securities that cannot be maintained by a qualified custodian. For these assets, which include physical commodities, the Proposal would require independent public accountants to "promptly" verify each transaction, and verify the existence and ownership of each client's privately offered securities and physical assets annually. Assets such as physical commodities trade and travel all over the world throughout the day. Involving an auditor in each transaction is neither commercially nor practically feasible, and the sheer volume of transactions required to be verified would likely outstrip auditing firms' capacity. This requirement would introduce significant costs for no discernible benefit. More broadly, the Proposal would consolidate market activity into a smaller number of participants, diminishing the breadth of participation, compromising market resiliency, and reducing competition. Collectively, this would lead to higher prices for consumers of wheat, corn, natural gas, gasoline and other essential commodities globally.

The Proposal would also require investment advisers and their clients to renegotiate potentially all of their custody and trading agreements and compel the addition of off-market and undesirable terms. The costs of such an undertaking would be immense, and would ultimately be borne by clients and investors.

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[2] *See, e.g.*, BCBS-IOSCO, "Margin requirements for non-centrally cleared derivatives," p. 20 (April 2020) ("Cash and non-cash collateral collected as variation margin may be re-hypothecated, re-pledged or re-used") available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD651.pdf; Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants and Capital, 81 Fed. Reg. 636 (Jan. 6, 2016) available at https://www.govinfo.gov/content/pkg/FR-2016-01-06/pdf/2015-32320.pdf, at 688 ("The Commission understands that prohibition against rehypothecation will impose significant costs on market participants as this will increase their funding costs for margin").

[3] Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, 84 Fed. Reg. 163 (Aug. 22, 2019) (codified at 17 C.F.R. Pts. 200 and 240), available at https://www.govinfo.gov/content/pkg/FR-2019-08-22/pdf/2019-13609.pdf, at 44027-28 ("The Commission has considered the costs and benefits of requiring segregation at a third-party custodian and prohibiting re-hypothecation. Based on its judgment and prior experience, the Commission determines that the potential benefits to financial stability do not justify the potentially considerable additional costs that would need to be borne by market participants under this alternative approach.").

Finally, the Proposal clearly exceeds the Commission's statutory authority. The term "client assets" in the Investment Advisers Act of 1940 ("Advisers Act") refers to client funds and securities. The Commission's 2009 custody rule defined "client assets" as a shorthand to refer to client funds and securities."[4] Section 411 of the Dodd-Frank Act—enacted just six months after the adoption of the 2009 custody rule—parroted the term "client assets." This context, along with a plain reading of the statute, confirms that the term "client assets" does not extend beyond funds and securities. Moreover, the Proposal improperly encroaches upon the statutory exclusive jurisdiction of other regulatory agencies.

Given the Proposal's serious flaws and the Commission's failure to assess its costs and impacts, it should be withdrawn in its entirety. Once withdrawn, the Commission should consult with other regulatory agencies, ensure that experts in its own Division of Trading and Markets have weighed in, and engage in a dialogue with market participants regarding whether targeted improvements to the existing investment adviser custody framework are necessary or appropriate. Then and only then should the Commission consider whether to repropose a rule in a state that is workable and affords market participants with the opportunity to accurately assess its implications and meaningfully comment.

[4] Custody of Funds or Securities of Clients by Investment Advisers, 75 Fed. Reg. 1456, 1456 & n.1 (Jan. 11, 2010).

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I. The Proposal would disrupt critical financial and commodities markets

The Proposal would disrupt critical financial and commodities markets, both domestically and internationally. Before proceeding the Commission must consider the effects of the Proposal on all of the additional asset classes and instruments that would be subject to the new safeguarding framework, and coordinate with regulators that directly regulate these affected markets. The Commission must also assess whether the Proposal will "promote efficiency, competition, and capital formation."[5] Neglecting these statutory duties—failing to "apprise itself … of the economic consequences of a proposed regulation"—constitutes an arbitrary and capricious failure to consider statutorily required factors, in violation of the Administrative Procedure Act, 5 U.S.C. § 551 et seq.[6] Imposing numerous impractical requirements and multiple regulations that are incompatible with a myriad of significant markets would harm investors and is clearly contrary to the Commission's policy objective of promoting market efficiency.

a. Cleared Derivatives (Futures and Swaps)

Cleared derivatives would be subject to the new requirements of the Proposal. However, the Proposal does not include futures commission merchants ("FCMs"), the regulated entities responsible for holding futures and cleared swaps, as qualified custodians for cleared derivatives. Specifically, under the Proposal, an FCM is only a qualified custodian with respect to "clients' funds and security futures, or <u>other securities</u> incidental to transactions in contracts for the purchase or sale of a commodity for future delivery and options thereon." Without a qualified custodian, the Proposal would effectively prohibit funds from investing in futures and cleared swaps.

The Commission failed to analyze how the Proposal would impact trading in these instruments. If the Commission intended to prevent registered investment advisers from transacting in cleared derivatives, this decision should have been fully discussed, and the costs of such a dramatic change in policy should have been fully evaluated in the Commission's cost-benefit analysis.[7] If, in the alternative, the Commission intended for FCMs to serve as qualified custodians and failed to make commensurate changes to the definition of qualified custodian, this is evidence that the Commission was hasty and premature in issuing this significant rulemaking, and underscores the need for withdrawal while the Commission fully and properly considers, on an asset class-by-asset class basis, if any changes are even necessary given the characteristics of specific assets, existing regulatory frameworks, and how the Commission's proposed requirements would operate within specific markets.

Assuming the Commission meant to include FCMs as qualified custodians for futures and cleared swaps markets, it is not clear whether FCMs could satisfy the requirements of the Proposal. FCMs are already subject to a comprehensive regulatory framework under the Commodity

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[5] 15 U.S.C. §80b-2(c).

[6] *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005).

[7] Despite the size and importance of these markets, the entire 432-page release contains approximately four references to futures contracts and six references to swaps, with no substantive discussion or analysis regarding how the Proposal is intended to apply to such instruments.

Exchange Act ("CEA") and subject to the oversight of the Commodity Futures Trading Commission ("CFTC") and National Futures Association ("NFA"). The Proposal would require, for example, an investment adviser to obtain written assurances that a qualified custodian will "indemnify the [advisory] 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." CFTC rules, however, prohibit FCMs from guaranteeing against certain losses and require FCMs to provide prominent risk of loss disclosures.[8]

It is unclear if FCMs could reasonably obtain the insurance the Proposal would require. Even if such insurance were available, it would significantly increase the cost of FCM services, costs which would ultimately be borne by investors.

The Commission failed to consider the increased costs to advisory clients for FCM services that would result from the Proposal, whether the proposed requirements are compatible with the CEA and CFTC rules thereunder, or the effects the Proposal would have on the functioning of the cleared derivatives markets. Moreover, the Commission has offered no evidence of a market failure, or findings of inadequacies with the existing CFTC regulatory framework, that would justify such a drastic departure from well-established precedent.

The Proposal also impermissibly intrudes on the CFTC's authority to regulate commodity trading advisers. Funds advised by investment advisers that are dually registered with the CFTC often employ various investment strategies in the commodities markets. The fact that an investment adviser is required to register with the SEC does not give the SEC plenary authority to regulate all of that adviser's activities. Commodity trading activities are not only outside of the Commission's competence – but also outside its statutory authority. Indeed, Congress has afforded the CFTC with *exclusive* jurisdiction, and under governing legal precedent, the Commission's encroachment on such jurisdiction would be unlawful.[9] As proposed, the Commission would not only intrude, but effectively prevent dually-registered investment adviser/commodity trading advisers from accessing the cleared derivatives markets.

According to ADV data published by the Commission, there are currently 2,246 investment advisers registered with the SEC that are actively engaged in business as a commodity pool operator or commodity trading adviser.[10] Form PF data published by the Commission's analytics office states that, as of the second quarter of 2022, aggregate qualifying hedge fund[11] gross notional exposures to interest rate derivatives amounted to $7.5 trillion, and gross notional

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[8] Prohibition of Guarantees Against Loss, 46 Fed. Reg. 62,841, 62,842 (Dec. 29, 1981).

[9] The CFTC has "exclusive jurisdiction" over "transactions involving swaps or contracts of sale of a commodity for future delivery." 7 U.S.C. § 2(a)(1)(A); see, e.g., *Hunter v. FERC*, 711 F.3d 155, 158 (D.C. Cir. 2013) (invalidating another regulatory agency's purported regulation on the grounds of the CFTC's "exclusive jurisdiction over commodity futures contracts").

[10] Information About Registered Investments Advisers and Exempt Reporting Advisers, (data for Registered Investment Advisers, May 2023) available at https://www.sec.gov/help/foiadocsinvafoia.

[11] A "qualifying hedge fund" is a hedge fund that is advised by a "Large Hedge Fund Adviser" (i.e., an adviser with at least $1.5 billion in hedge fund assets under management) with a net asset value of at least $500 million.

exposures to commodity derivatives amounted to $399 billion.[12] As proposed, the Commission would force advisers out of these markets, preventing advisory clients from pursuing investment strategies outside of the SEC's purview. This would not only harm these critical, CFTC-regulated markets by reducing liquidity and price discovery, but also the U.S. and global economies that rely on them.

b. Uncleared OTC Derivatives

The Proposal would be unworkable in the context of uncleared OTC derivatives including swaps and security-based swaps. These instruments are privately negotiated, bilateral contracts between an advisory client and a counterparty. They are generally subject to both initial margin and variation margin requirements based on both minimum regulatory requirements as well as additional risk management specific add-ons. For the life of the contract, the client of an investment adviser and a swap counterparty are parties to the contract and are responsible for making payments or deliveries to one another under the terms of the contract. The regulatory minimum initial margin must be segregated and held by an independent custodian, excess/non-regulatory initial margin may by contract be segregated or available for rehypothecation, and variation margin is not segregated and fully available for rehypothecation by the receiving party. Dealers and other counterparties to uncleared OTC derivatives transactions are extensively regulated by the Commission and/or the CFTC following the enactment of the Dodd-Frank in the United States, and through other regulatory regimes globally.

To comply with the Proposal, an adviser would ostensibly be required to place the bilateral contract with a qualified custodian that would "maintain possession or control" over the contract, meaning that the qualified custodian would be required to participate in any change in beneficial ownership. As a result, advisers would depend on qualified custodians to agree to become a party to each transaction, such as by becoming a party to the relevant ISDA Master Agreement. This would inappropriately force qualified custodians into these bilateral relationships, placing upon them the authority to delay, alter or even veto transactions or amendments, which would fundamentally alter the bilateral nature of these arrangements. It is unclear whether any qualified custodians would agree to such a role, and the need for transaction-by-transaction approval from the qualified custodian would insert unfathomable delays into the trade execution process.

The Proposal would also extend safekeeping requirements to all underlying collateral, including collateral traditionally subject to rehypothecation. As a result, all of an advisory client's margin would be subject to the requirement that it be held by a qualified custodian in a segregated account. This requirement would constitute a substantial departure from market practice and is inconsistent with a decade of rulemaking from various financial regulators pursuant to the Dodd-Frank Act.

All relevant U.S. financial regulators permit rehypothecation of variation margin. Indeed, the text of the Dodd-Frank Act itself specifically excluded variation margin from the uncleared swap margin segregation requirements.[13] In adopting segregation requirements for security-based swap

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[12] Private Fund Statistics, Second Quarter 2022 at Table 46 (Jan. 3, 2023) available at https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2022-q2.pdf.

[13] *See* Section 724(c)(2)(B)(i) of Dodd-Frank; Section 4s(l)(2)(B)(i) of the CEA.

dealers, the Commission itself stated: "The Commission has considered the costs and benefits of requiring segregation at a third-party custodian and prohibiting re-hypothecation. Based on its judgment and prior experience, the Commission determines that the potential benefits to financial stability do not justify the potentially considerable additional costs that would need to be borne by market participants under this alternative approach."[14] Requiring segregation of variation margin would have significant implications for a myriad of fund investment, trading and risk management activities given that variation margin received would be unavailable for use, including to satisfy variation margin posting requirements for correlated and/or hedging transactions.

If the Commission intended to require all margin exchanged in connection with uncleared OTC derivatives to be segregated, this would constitute a significant change in policy deserving of significant discussion and analysis, and joint regulatory action. The Proposal, however, contains no discussion or analysis of the effects of this change, including both with respect to the security-based swaps markets under its own purview, and the broader OTC derivatives markets regulated by other federal agencies. Once more, if this change was unintentional, it is clear evidence that the Proposal was not properly considered and must be withdrawn.

c. Physical Commodities

The Proposal would prevent advisory clients from investing in physical commodities. The Proposal sets forth an unworkable alternative custody framework for "physical assets," including commodities. As part of this framework, the adviser must (i) notify an independent public accounting firm within one business day of any transaction, (ii) the independent public accounting firm must verify each purchase, sale or other transfer of beneficial ownership of such assets "promptly"; and (iii) the existence and ownership of each of the client's commodities must be verified annually.

The proposed requirements are unworkable in markets for physical commodities, which by definition are actively traded. Commodities markets consist of countless millions of participants transacting at numerous locations all around the world. The commodities themselves trade bilaterally as well as on platforms that operate around-the-clock. In the natural gas markets, the trading destinations are not necessarily stand-alone storage structures but segments of individual pipelines or locations where pipelines interconnect with other pipelines or local distribution companies. It would be impossible for an independent public accountant to verify each transaction in a commodity, let alone in situation where commodities are bought and sold multiple times a day. It speaks volumes that all the major independent public accounting firms that would be tasked with this significant undertaking – including Deloitte, KPMG, and E&Y – have similarly described the Proposal as not just vague, but unworkable. They have pointed out that the sheer volume of transactions required to be verified would outstrip their capacity;[15] that the industry-specific

[14] Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, 84 Fed. Reg. 163 (Aug. 22, 2019).

[15] *See* Letter from KPMG LLP (May 8, 2023) ("Considering the potential volume of verifications to be performed for each individual client of the investment adviser, there would likely be challenges completing the robust requirements of an examination within the proposed timeframe. In addition, obtaining sufficient appropriate evidence upon being

expertise required to verify different commodities would outstrip their capabilities;[16] and that the Proposal would impose significant costs for no discernible benefit.[17]

Here again the Commission would be encroaching on the jurisdiction of various other regulatory agencies. Several of these regulatory agencies have statutory exclusive jurisdiction over their regulated commodities, and all of them have decades of experience and industry-specific expertise that the Commission does not have. For example, many funds trade various forms of energy, including natural gas, oil, and electricity. Interstate possession and control of these products in the U.S. is already subject to regulation by the Federal Energy Regulatory Commission ("FERC"). Using natural gas as an example, FERC regulations already set forth complex standards regarding title transfer and pipeline and storage capacity. Under the Natural Gas Act and FERC regulations, shippers on natural gas pipelines are required to have title to the gas being shipped on the pipeline capacity. Adding a new layer of SEC regulation, including auditor verification, would interfere with pipeline tariff and scheduling administration, and would add costly, unnecessary, and unworkable delays.

The Proposal would materially reduce liquidity and price discovery of various other important commodities markets, including metals, agricultural commodities, renewable energy credits and carbon markets, among many others. Investors play an essential and beneficial role in the commodities markets. Commodity market investors perform extensive fundamental research and analysis, examining troves of data and conduct detailed modeling of market trends and dynamics, to guide their investing activity. By bringing their informed investment decisions to the marketplace, investors contribute meaningfully to the price formation and discovery process. This in turn facilitates more efficient economic decisions by commodity producers and consumers and optimizes resource allocation across the real economy. Efficient commodity markets optimize economic output by informing the forward capital investment and resource allocation decisions of farmers planting crops or energy producers drilling new wells, among others.

Investors are also critical to commodity market liquidity. Commodity producers and direct consumers of those commodities only "meet" directly, if at all, by chance given the different sizes, durations, and specifications of their risk management needs, and the size of the marketplace. Instead, investors, market makers and others provide needed liquidity to enable producers and consumers to hedge their risks and achieve their commercial goals. The availability of investor

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notified of a change in beneficial ownership may require more time than proposed due to the likely complex nature of the assets not maintained with a qualified custodian").

[16] *See* Letter from Deloitte & Touche LLP (May 3, 2023) ("Not all independent public accountants have the specific expertise or resources necessary to verify such a wide variety of assets. Because of this, there may be limitations on the availability of independent public accountants to perform such services").

[17] *See* Letter from Ernst & Young LLP (May 8, 2023) ("We do not believe the proposed asset verification procedures would add meaningful additional protections, and we believe they would be costly. As noted in the proposal, POS and physical assets, such as real estate and commodities, are not as likely to be subject to misappropriation").

capital to take both long and short positions, assimilate copious amounts of information, and express countervailing views, creates deep, liquid and efficient markets.

d. Other Markets

Given the Commission's indiscriminate approach of subjecting every asset class to its new safeguarding rule, it is nearly impossible to determine and list each market that will be disrupted by the Proposal, particularly given the limited public comment period and the Commission's inadequate survey and analysis of affected markets. We note, for example, despite the size and importance of the swaps markets, the entire 432-page release references the term "swap" six times and none of these references specifically discuss how the Proposal is intended to apply to such contracts.[18] In addition to the markets discussed above, many others will certainly be negatively impacted, including repurchase agreements/reverse repurchase agreements,[19] cash deposits,[20] privately offered securities,[21] and loans and various securitized products.[22]

The Commission's failure to analyze the effects of the Proposal on these various markets is a fatal flaw that requires the Proposal to be withdrawn in its entirety. Prior to any determination to re-propose a new safeguarding rule, the Commission must analyze how the proposed rule will impact the markets affected and appropriately tailor the rule's requirements to the underlying assets proposed to be covered.

II. The Proposal will prevent funds from obtaining standard prime brokerage and banking services

The Proposal is inconsistent with the customer protection rules under the Exchange Act and will prevent funds from obtaining standard prime brokerage services. Prime brokers offer important margin lending services through regulated "margin accounts." Under Exchange Act Rule 15c3-3, fully paid for and excess margin securities must be segregated and kept within the broker-dealer's possession and control, but margin securities may, up to certain limits, be "de-segregated" and rehypothecated.

As described above, the Proposal would require qualified custodians to "segregate all client assets from the qualified custodian's proprietary assets and liabilities." Segregation prevents rehypothecation, which would disrupt existing well-functioning custodial practices. The right to rehypothecate securities is an important factor in supporting a prime broker's ability to lend shares to support the short positions of its clients. Where a client has agreed to permit a broker-dealer to

[18] In contrast, we note that the Commission references the term "crypto assets" 182 times throughout the release.

[19] Market participants will be unable to meet the Commission's segregation requirements with respect to repurchase agreements.

[20] We understand that the segregation requirements are incompatible with bank deposit practices. Please refer to the letters submitted by the American Bankers Association and SIFMA, among others.

[21] As discussed above, the Proposal would introduce significant costs and delays with respect to transactions in privately offered securities and other physical assets that cannot be held by a qualified custodian.

[22] Please refer to the letters submitted by the MFA, SIFMA and Loan Syndications and Trading Association for discussions of the Proposal's impact on the trading of loans.

rehypothecate securities pursuant to the client's margin agreement, these securities will be included among shares in a de-segregated pool of assets that a broker-dealer may access based on its funding needs and delivery obligations (referred to as its "free box").

Eliminating rehypothecation and requiring all assets to be segregated would require self-funding of all prime brokerage exposures, which would significantly increase the cost of short selling (not to mention the cost of financing long positions). Once again, this would constitute a striking reversal of Commission policy. Where the Commission has addressed short selling directly, it has acknowledged the benefits of the practice to market efficiency, and intentionally sought to avoid unnecessary burdens. In another proposal currently under consideration, for example, the Commission states "academic studies, both theoretical and empirical, have shown that when short selling becomes more costly, stock prices are less reflective of fundamental information both because costly short selling makes trading on information difficult, and because costly short selling dissuades investors from collecting information in the first place."[23] If the Commission intended to impose undue burdens on short selling, its intent to do so should have been clearly stated, and the effects of such a change analyzed.

Similarly, the segregation requirement would prevent custody banks from maintaining an advisory client's cash balances in general deposit accounts, which are used by custodian banks to support custody services. Requiring all cash balances to be held in special deposit accounts would increase operational complexities and the costs of custody services for advisory clients, further reducing client returns.

The Commission failed to analyze the costs and effects of preventing funds from obtaining standard prime brokerage and banking services. Eliminating rehypothecation and requiring all assets to be segregated would materially reduce the amount of liquidity available to funds. This would also result in a significant re-pricing of prime brokerage and banking services, and require self-funding of all prime brokerage exposures. Moreover, it is questionable whether the Proposal would result in *any* incremental customer protections, given the robust existing protections under the Exchange Act, insolvency protections afforded under the Securities Investors Protection Act of 1970 ("SIPA"), and relevant banking laws.

III. The requirement that advisers enter into written agreements with its clients' custodians would necessitate the renegotiation of nearly all custody and trading agreements

The Proposal would require that advisers enter a written agreement with its clients' qualified custodians specifying certain conditions the qualified custodians must adhere to when maintaining its clients' assets, and advisers would be required to "maintain an ongoing reasonable belief" that the custodians are complying with these conditions. Many of the conditions that must be included in the written agreement are undesirable and costly to investors, and considerably off-market. These include requiring the qualified custodian to agree to (i) indemnify the client (and 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

[23] Short Position and Short Activity Reporting by Institutional Investment Managers, 87 Fed. Reg. 14950, 14994 (Mar. 16, 2023)

simple negligence; and (ii) clearly identify the client's assets as such, hold them in a custodial account, and segregate all client assets from the qualified custodian's proprietary assets and liabilities.

The "written agreement" requirement would necessitate the renegotiation of nearly all custody and trading agreements—which can number well into the hundreds—for no clear benefits to advisory clients. Rather than enhancing protections for clients, the Proposal is likely to saddle clients with significantly greater costs for custodial services, which will directly reduce investor returns. Institutional investors, such as funds, are fully capable of negotiating a standard of care and liability that is suitable to their needs. The costs of requiring a simple negligence indemnity will disproportionately harm investors in sophisticated funds with complex needs and requirements. We further expect that some of the most sophisticated custodians may be unwilling or unable to agree to such terms for risk management or other reasons, which would force advisers into custodial relationships with potentially less reputable or less sophisticated custodians that would be willing to take on such risks. Such an outcome would not benefit advisory clients, and in fact, is likely to introduce more custodial risk than exists today.

In addition, as discussed above, the requirement that qualified custodians segregate client assets from the custodian's own assets and liabilities would prohibit rehypothecation of collateral. This would prevent funds from obtaining standard prime brokerage and banking services, and prevent funds from engaging in a wide range of transactions, including uncleared OTC derivatives repurchase agreements/reverse repurchase agreements, and other financing transactions.

Coming into compliance with the Proposal's written agreement requirements would be an extraordinary undertaking. The scope of such a project is made even greater than it would be today, given the proposed expansion of the rule to all assets, which would bring significantly more custody and trading arrangements into scope. Qualified custodians would likely need to reshape their entire business to accommodate these requests, a process which could take years. Advisers and their clients would be disadvantaged in these negotiations, given that the adviser faces regulatory risk if they are unable to obtain such terms and conditions. The Commission's analysis of the costs of entering these agreements is understated and wholly inaccurate. The Commission's suggestion that it will take advisers one hour to prepare each written agreement is vastly understated, as each agreement could take orders of magnitude longer to negotiate.

In addition to understating the costs of preparing the written agreement for the adviser, the Commission engages in no analysis regarding the costs and time applicable to renegotiating existing custody and trading documentation between advisory *clients* and their custodians. While the proposed rule directly requires registered investment advisers to enter a written agreement with a client's qualified custodian, the proposed rule requires the written agreement to specify certain terms that must be in the advisory client's custody and trading agreements. The client (i.e., the fund) must then renegotiate their custody and trading agreements to address the Proposal's requirements before an investment adviser can enter the agreement contemplated by the Proposal. Thus, clients will likely bear the brunt of the costs and expenses associated with this exercise. The

Commission's failure to consider an entire category of costs is fatal to its cost-benefit analysis under applicable case law.[24]

For these reasons, the Proposal's requirement that advisers obtain reasonable assurances from custodians should not be adopted. At minimum, the Commission must avoid disrupting various markets and preventing advisory clients from accessing standard brokerage and banking services. The Commission must also adequately reflect the costs of such a significant undertaking in its economic analysis. As part of this effort, the Commission should coordinate with other regulators regarding potential inconsistencies with other regulatory frameworks. A reasoned analysis would demonstrate that the costs of its "written agreement" requirement far outweigh any purported benefits to advisory clients.

IV. The Commission should eliminate the unnecessary and disruptive requirements that would apply to FFIs acting as qualified custodians

The Proposal's new requirements applicable to qualified custodians that are foreign financial institutions ("FFIs") will likely prevent funds from investing in various foreign markets. Funds access foreign markets through FFIs. FFIs generally serve as custodians or sub-custodians when an adviser is investing in foreign securities and instruments that U.S. qualified custodians do not custody.

The Proposal seeks to impose new requirements on FFIs, and advisers that engage FFIs, that are inappropriate and unworkable. Specifically, before an adviser can treat an FFI as a qualified custodian, the adviser must determine that, among other things, the FFI (i) can be subject to judgments that originate in the United States; (ii) holds financial assets for its customers in an account designed to protect such assets from creditors of the FFI in the event of the insolvency or failure of the FFI and (iii) has the requisite financial strength to provide due care for client assets. In proposing these requirements, the Commission failed to analyze whether they are workable in foreign markets. Assuming FFIs cannot meet the Commission's requirements in various foreign jurisdictions, the Commission failed to assess the costs of prohibiting advisory clients from accessing these markets.

For example, it is unclear whether FFIs in various foreign jurisdictions could meet the proposed requirement that the SEC be able to enforce judgments, including civil monetary penalties, against the FFI. This could create complex extraterritoriality issues where the FFI could not comply with both the Proposal's requirements and applicable foreign law where the FFI is located. More broadly, the enforceability of rights and remedies among advisers, clients and custodians is a commercial matter between the counterparties. It is not clear from the Proposal what civil monetary penalties and other judgments the Commission might seek to enforce against FFIs, or how such enforcements would relate specifically to the custody of assets. Notably, to the extent the Commission registrant (i.e, the adviser) is involved in misconduct, the Commission already has authority to pursue such misconduct under the Advisers Act.

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[24] *See Business Roundtable*, 647 F3d at 1150 (invalidating a Commission proxy rule because the Commission failed to "estimate and quantify" the costs that result when companies oppose shareholder nominees in election contests, and failed to state in the alternative that these costs could not be estimated).

Similarly, it is unclear whether FFIs in various foreign jurisdictions can hold assets in a manner that protects such assets from creditors of the FFI in the event of the insolvency or failure of the FFI. Assessing whether FFIs can meet this obligation is a significant undertaking and would require advisers to attempt to analyze various foreign bank solvency regimes. A custodian's responsibility for the safekeeping of financial instruments held in custody for its clients has always been addressed by the relevant national and state laws that apply to it. Advisers and their clients are fully capable of assessing the risks associated with investing in foreign markets, including custodial risks, and managing their investments accordingly.

Finally, the Commission's proposed requirement that advisers determine that the FFI "has the requisite financial strength to provide due care for client assets" inappropriately subjects investment advisers to regulatory risk in the event of the insolvency of a client's custodian. As stated above, funds and advisers already have commercial incentives to assess the risks of their service providers. As recent events have made clear, U.S. or non-U.S. financial institutions can become unexpectedly impaired, even when traditional metrics suggest an institution is financially sound. It is unreasonable to expect that an adviser could effectively predict such an occurrence, and the Proposal leaves investment advisers open to the risk of second-guessing and regulatory enforcement by the Commission for events outside of the adviser's control.

V. The Commission's cost-benefit analysis is deeply flawed

The Investment Advisers Act of 1940 requires the Commission to determine whether a rulemaking will "promote efficiency, competition, and capital formation."[25] The Commission's analysis here is clearly insufficient.

As an initial matter, the economic analysis appears to claim that the Proposal is designed to address a "market failure" resulting from "principal-agent problems [] result[ing] when investment advisers and custodians have different preferences and goals than clients." Notwithstanding this sweeping claim, the Commission presents "no evidence" that misappropriation of client assets is anything but an extraordinary occurrence in the investment advisory industry.[26] The Commission's failure to present *any* evidence of misappropriation, including in the wide range of new asset classes it seeks to regulate, would constitute a violation of the Administrative Procedure Act. "Professing that an order ameliorates a real industry problem but then citing no evidence demonstrating that there is in fact an industry problem is not reasoned decisionmaking."[27] Indeed, in the exceedingly rare circumstances such misconduct has occurred, the Commission "*already*" has ample authority to pursue such misconduct under its existing anti-fraud authorities,[28] to say nothing of the Department of Justice's criminal authorities.[29]

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[25] 15 U.S.C. § 80b-1.

[26] *Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 843 (D.C. Cir. 2006) (Kavanaugh, J.).

[27] *Id.*

[28] *Business Roundtable v. SEC*, 647 F.3d 1144, 1155 (D.C. Cir. 2011) (emphasis added).

[29] *See Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 179 (D.C. Cir. 2010) ("the SEC's analysis is incomplete because it fails to determine whether, under the existing regime, sufficient protections existed").

With regard to the expanded scope of assets, the Proposal states "the proposed rule reduces the risk of loss of client assets by expanding the types of assets covered by the rule 'beyond funds and securities.'"[30] Further, "[b]ringing more categories of assets into the scope of the rule's requirements will protect investors because the assets will be subject to custodial safeguards."[31] But there is no clear basis for either statement, given that the Commission offers "no evidence" of misappropriation by investment advisers in the various new asset classes covered by the Proposal.[32] Given the remarkable costs and disruptions that would result from the Proposal, the burden is on the Commission to show that the benefits outweigh the costs. The Commission, however, has provided no evidence of widespread fraud or misappropriation by investment advisers for the myriad of new assets the Commission proposes to subject to the new rule and the Commission has failed to articulate a real problem it is attempting to solve for. The Commission's theoretical concerns alone cannot justify a Proposal of this magnitude; rules must be "based on some logic and evidence, not sheer speculation."[33] The Commission's failure to adduce any evidence of widespread misappropriation and corresponding benefit of the Proposal for these new asset classes renders its cost-analysis fatally flawed.[34]

As detailed above, the Proposal fails to consider—let alone analyze the economic effects of—the significant market disruptions that would be caused by the rule. Significant markets would be made inaccessible to investment advisers and their clients if adopted as proposed. This would reduce returns for investors, increase risks through reduced diversification of advisory client portfolios, and prevent advisory clients from accessing standard prime brokerage and banking services. In turn, markets affected by the Proposal are likely to see reduced efficiency and liquidity, which could pose additional risks to the overall U.S. economy.

To the extent the Proposal does attempt to quantify costs associated with the Proposal, the Commission's estimates are grossly understated. For example, the Commission estimates it will take advisers 1 hour to prepare written agreements with custodians, and that each adviser will enter into approximately 4 written agreements.[35] In reality, many advisers and their clients will need to revise potentially hundreds of agreements. The off-market terms the Commission proposes will require substantial negotiation and discussion, which could take orders of magnitude longer to negotiate.

With regard to the accountant verification requirement, the Commission estimates that advisers across the entire industry will send a total 8,000 notices annually, with each verification taking approximately 15 hours. The Commission appears to have based its estimate of 8,000 notices

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[30] Proposal at 14741.

[31] Proposal at 14741.

[32] *Nat'l Fuel Gas Supply*, 468 F.3d at 843; *cf. Am. Equity*, 613 F.3d at 178 ("The SEC could not accurately assess any potential increase or decrease in competition, however, because it did not assess the baseline level of price transparency and information disclosure under state law.").

[33] *Sorenson Commc'ns Inc. v. FCC*, 755 F.3d 702, 708 (D.C. Cir. 2014).

[34] *Business Roundtable*, 647 F.3d at 1150 (invalidating a Commission proxy rule because the Commission relied on "insufficient empirical data" for its conclusion that the rule would, by increasing the likelihood that dissidents would sit on corporate boards, improve the performance of corporations).

[35] Proposal at 14765.

entirely on information regarding private equity transactions.[36] The Commission does not account for all of the other asset classes that would be forced to rely on the proposed alternative verification framework, including physical commodities, intangible commodities, real-estate and other physical assets. To the extent these assets require specialized knowledge, experience, or regulatory expertise by the auditor, the Commission's 15-hour estimate is likely significantly understated. The Commission's analysis also ignores the substantial costs associated with the need for public accounting firms to hire and provide specialized industry-specific training to cadres of new personnel (if they can be found) to try to monitor and verify thousands of commodities trades across a range of asset classes.

Both the Supreme Court and the Courts of Appeals have held that an agency conducting a cost-benefit analysis must collect and analyze evidence of costs as well as benefits. In *Michigan v. EPA*, for example, the Supreme Court held that it was unreasonable for the Environmental Protection Agency to ignore certain costs when determining whether a regulation was "appropriate and necessary."[37] As the Court observed, "[a]gencies have long treated cost as a centrally relevant factor when deciding whether to regulate," since "reasonable regulation ordinarily requires paying attention to the advantages *and* disadvantages of agency decisions."[38] Likewise, in *Business Roundtable*, the D.C. Circuit held that the Commission acted arbitrarily by failing "adequately to assess the economic effects of a new rule."[39] The Commission must "make [the] tough choices" involved in "estimat[ing]" the economic effects of its proposals, but here, as in *Business Roundtable*, the Commission has once again fallen far short of this requirement.[40]

VI. The Proposal exceeds the Commission's statutory authority

The Proposal also exceeds the Commission's statutory authority. Like other federal agencies, the Commission "literally has no power to act … unless and until Congress confers power upon it."[41] Under the Administrative Procedure Act, an agency action is unlawful if it is found to be "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."[42] Here, Congress authorized the Commission in section 223 of the Advisers Act to require investment advisers to take certain "steps to safeguard client assets."[43] The term "client assets" refers *only* to client funds and securities, and does not encompass other, non-securities investments, such as swaps or physical commodities. Yet, with the Proposal, that is exactly what the Commission attempts to claim authority over.

Section 223 of the Advisers Act, enacted in 2010 as part of the Dodd-Frank Act, codified the existing regulatory understanding of "client assets," which was limited to client funds and

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[36] Proposal at fn 646.

[37] 135 S Ct. 2688 at 2707–08.

[38] *Id.* at 2707.

[39] 647 F.3d at 1150.

[40] *Id.* at 1150.

[41] *N.Y. Stock Exch. LLC v. SEC*, 962 F.3d 541, 553 (D.C. Cir. 2020).

[42] 5 U.S.C. § 706(2)(C).

[43] 15 U.S.C. § 80b-18b.

securities. Since 1962, the Commission's custody rule has encompassed "client funds and securities."[44] ("Funds" refers to cash held for investment in securities.[45]) In 2009, the Commission explicitly defined the term "client assets" as a shorthand reference to the phrase "client funds and securities."[46] As the Commission explained at the time, the Commission's use of the phrase "client assets" "d[id] not modify the scope of client funds or securities subject to th[e] rule."[47] When Congress adopted this exact terminology ("client assets") just six months later,[48] it presumptively intended to incorporate the established meaning of the phrase "client assets" as referring only to client funds and securities.[49]

The Commission's contrary assertion—that Congress intended for the term "client assets" to expand *beyond* "funds and securities"—has no support. The Commission notes that an earlier version of the Dodd-Frank Act referred to custody of client "funds and securities,"[50] as opposed to "client assets," but drawing any inference from this legislative history is disfavored in statutory interpretation.[51] The only reasonable inference cuts against the Commission anyway. When Congress replaced the phrase "funds and securities" with a term ("client assets") that the Commission had just recently defined as a shorthand for "funds and securities," the unmistakable implication is that Congress was adopting the *same* shorthand for "funds and securities." The Commission cannot overcome the presumption that Congress legislated against the existing regulatory backdrop.

Statutory context confirms that the term "client assets" does not extend beyond funds and securities. Section 223 applies only to registered "investment adviser[s]."[52] And the term "investment adviser" refers only to an advisory relationship concerning "*securities*," *i.e.*, to one who provides advise "as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who . . . issues or promulgates analyses or reports concerning

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[44] *See* Custody or Possession of Funds or Securities of Clients, 27 Fed. Reg. 2149, 2149 (Mar. 6, 1962) (requiring "investment advisers who have custody or possession of funds or securities of clients to segregate the securities and hold them in safekeeping and to set up a separate trust account in a bank for funds belonging to each client").

[45] The Commission's 1962 custody rule explicitly contemplated that "funds" would be held in a bank. *See id*. The Commission's 2003 custody rule, likewise, confirmed that "funds" referred to "cash." *See* Custody of Funds or Securities of Clients by Investment Advisers, 68 Fed. Reg. 56692, 56692 (Oct. 1, 2003) ("An adviser that holds clients' stock certificates or cash, even temporarily, puts those assets at risk of misuse or loss." (emphasis added)).

[46] Custody of Funds or Securities of Clients by Investment Advisers, 75 Fed. Reg. 1456, 1456 & n.1 (Jan. 11, 2010).

[47] *Id.*

[48] *See* 15 U.S.C. § 80b–18b ("An investment adviser registered under this subchapter shall take such steps to safeguard *client assets* over which such adviser has custody . . . ." (emphasis added)).

[49] *See, e.g.*, *George v. McDonough*, 142 S. Ct. 1953, 1959 (2022) ("Where Congress employs a term of art obviously transplanted from another legal source, it brings the old soil with it." (internal quotation marks omitted)); *Fisher v. Pension Benefit Guar. Corp.*, 994 F.3d 664, 671 (D.C. Cir. 2021) ("Congress . . . is presumed to preserve, not abrogate, the background understandings against which it legislates." (internal quotation marks omitted)); *Bloom v. Azar*, 976 F.3d 157, 163 (2d Cir. 2020) ("[W]e must presume that Congress acted against the prevailing regulatory backdrop[.]").

[50] 88 Fed. Reg. at 14674 & n.16.

[51] *See* Murphy v. Smith, 138 S. Ct. 784, 790 n.2 (2018) (rejecting an inference based on a comparison between the enacted legislation and an earlier draft of the bill).

[52] 15 U.S.C. § 80b–18b.

securities."[53] In this context, it is not plausible that the term "client assets" extends to holdings *beyond* the investment-advisory relationship—*i.e.*, beyond the custody of securities and the cash held for investment in securities.

The Proposal, however, would extend the Commission's reach beyond securities and the cash held for investment in securities. The Advisers Act explicitly defines "security," and that definition does *not* include many of the assets that the Commission suggests would be covered by "client assets," including swaps and commodities.[54]

Start with commodities. Under the long-existing definition of "security" in all of the federal securities laws, it is well-settled that commodities, including commodity derivatives, are not securities.[55]

Nor are swaps. The Advisers Act's definition of "security" does not include "swaps"—even though Congress knew how to refer to "swaps" in the Advisers Act,[56] and even though Congress, in the Dodd-Frank Act, explicitly added "swaps" to the *Exchange* Act's and *Securities* Act's definitions of "security."[57] This is powerful evidence that Congress deliberately excluded "swaps" from the scope of the Commission's jurisdiction under the Advisers Act.[58] Congress had a specific reason for doing so. In the Securities Act and Exchange Act (unlike the Advisers Act), the term "security" governs the scope of antifraud provisions.[59] But prior to Dodd-Frank, the antifraud provisions of those Acts *also* encompassed "security-based swap agreements."[60] Congress thus added "security-based swaps" to the definition of "security" in those Acts to differentiate between "security-based swaps" and "security-based swap agreements," and to clarify that the SEC had antifraud jurisdiction over both.[61] Congress had no reason to add—and did not add—"swaps" to the definition of "security" under the Advisers Act.

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[53] *Id.* § 80b–2(11); *see also id.* § 80b–1(2) ("it is found that investment advisers are of national concern in that . . . their advice . . . customarily relate[s] to the purchase and sale of securities").

[54] *See* 88 Fed. Reg. at 14674 n.14, 14678–79 (stating that "client assets" would encompass "other positions held in a client's account," including swaps and physical commodities); 15 U.S.C. § 80b–2(18) (Act's definition of "security").

[55] *See, e.g.*, *Moody v. Bache & Co., Inc.*, 570 F.2d 523, 525 (5th Cir. 1978) (explaining that courts "have widely agreed that a particular commodities futures contract is not in itself a security under the securities acts" (citing *SEC v. Cont'l Commodities Corp.*, 497 F.2d 516, 520 n.9 (5th Cir. 1974) (collecting cases))).

[56] *See, e.g.*, 15 U.S.C. § 80b–2(29) (defining "swap").

[57] *See* Pub. L. No. 111-203, § 761, 124 Stat. 1376, 1755 (2010) (amending 15 U.S.C. § 78c(a)(10) to include "security-based swap"); id. § 768, 124 Stat. at 1800 (similarly amending 15 U.S.C. § 77b(a)(1)).

[58] *See, e.g.*, *Russello v. United States*, 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." (alteration in original)).

[59] *See* 15 U.S.C. § 77q(a); id. § 78j(b).

[60] *See* Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, §§ 302(b), 303(d), 114 Stat. 2763A-365, 2763A-452, 2763A-454 (codified at 15 U.S.C. §§ 77q(a), 78j(b)).

[61] *See* Thomas J. Molony, Still Floating: Security-Based Swap Agreements After Dodd-Frank, 42 Seton Hall L. Rev. 953, 958–61, 988–92 (2012).

Regardless, swaps cannot be custodied. Section 223 contemplates that "client assets" are capable of being "custod[ied]" by an adviser.[62] But there is no sense in which a swap can be "custodied." A "swap," as defined in the Advisers Act, is "any agreement, contract, or transaction" through which two parties exchange cash flows or liabilities.[63] This is not the type of asset that can be "custod[ied]"—*i.e.*, "h[e]ld[]" or "possess[ed]."[64] Neither an adviser nor a qualified custodian would be able to hold or obtain possession of such a contract or transaction.

Fundamental principles of statutory interpretation reinforce the limits of the Commission's authority here. For nearly 90 years, Congress limited the Commission's jurisdiction under the Advisers Act to the investment-advisory relationship, which concerns "securities." Consistent with those regulatory limits, the Commission has historically regulated only custody of securities and the funds used to buy those securities. Now, the Commission contends that a single provision in the Dodd-Frank Act—and more specifically, a single term ("client assets")—vastly expands the Commission's jurisdiction over investment advisers. But, as the Supreme Court recently reaffirmed, Congress does not "typically use oblique or elliptical language to empower an agency to make a 'radical or fundamental change' to a statutory scheme."[65]

The Commission's attempt to expand its jurisdiction here would also impermissibly intrude on the CFTC's and FERC's exclusive jurisdiction over transactions involving swaps and commodities, further undermining the Commission's claim of statutory authority.

FERC has "exclusive jurisdiction" over the trading of electricity and natural gas in interstate commerce.[66] And the CFTC has "exclusive jurisdiction" over "transactions involving swaps or contracts of sale of a commodity for future delivery."[67] Yet the Proposal would cover these exact transactions. The Proposal reaches any situation where an adviser has authority "to issue instructions to a broker-dealer or a custodian to effect or to settle trades" "without first obtaining the client's consent."[68] And, as discussed, the Proposal extends not only to securities and funds, but also to swaps and commodities, including physical commodities and commodity derivatives.[69] Accordingly, the Proposal, if adopted, would subject to SEC oversight a custodian's involvement in transactions involving, for example, natural gas futures or physical natural gas. But overseeing those transactions is solely a job for the CFTC of FERC, respectively. Indeed, the

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[62] 15 U.S.C. § 80b–18b.

[63] 7 U.S.C. § 1a(47); *see* 15 U.S.C. § 80b–2(29) (incorporating definition of "swap" in 7 U.S.C. § 1a(47)).

[64] 88 Fed. Reg. at 14679.

[65] *West Virginia v. EPA*, 142 S. Ct. 2587, 2609 (2022); see also id. ("Extraordinary grants of regulatory authority are rarely accomplished through 'modest words,' 'vague terms,' or 'subtle device[s]'" (alteration in original) (quoting *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 462 (2001))).

[66] *See, e.g.*, *Hughes v. Talen Energy Mktg., LLC*, 578 U.S. 150, 153 (2016) (electricity); Schneidewind v. ANR Pipeline Co., 485 U.S. 293, 300–01 (1988) (natural gas).

[67] 7 U.S.C. § 2(a)(1)(A); *see, e.g.*, *Hunter v. FERC*, 711 F.3d 155, 158 (D.C. Cir. 2013) (invalidating another regulatory agency's purported regulation on the grounds of the CFTC's "exclusive jurisdiction over commodity futures contracts").

[68] 88 Fed. Reg. at 14680 (first quote), 14742 (second quote); *see also id.* at 14680 ("[D]iscretionary trading authority is an arrangement that triggers the rule.").

[69] *See id.* at 14674 n.14, 14678–79.

Proposal itself acknowledges that the CFTC already regulates custodians in the commodity derivatives space, and that the CFTC has *not* "defined possession or control in the custody context in a manner identical to [the] proposed [custody] rule."[70] But the Proposal fails to recognize the CFTC's exclusive jurisdiction to define "possession or control" in connection with transactions involving commodities, or FERC's in connection with natural gas.

A necessary premise of the SEC's expansive interpretation of "client assets" in 15 U.S.C. § 80b–18b is that this provision impliedly repealed the grant of exclusive jurisdiction to the CFTC and FERC over transactions and trading involving swaps and certain types of commodities. But "repeals by implication are not favored" and "will not be found unless an intent to repeal . . . is *clear and manifest*."[71] Indeed, "courts should not infer that one statute has partly repealed another unless the later statute expressly contradicts the original act or unless such a construction is absolutely necessary."[72] Neither condition is satisfied here, and thus the SEC cannot even come close to meeting the high bar for an implied repeal.

VII. Conclusion

Given the Proposal's serious flaws and the Commission's failure to assess its costs and impacts, it should be withdrawn in its entirety. Once withdrawn, the Commission should consult with other regulatory agencies, ensure that experts in its own Division of Trading and Markets have weighed in, and engage in a dialogue with market participants regarding whether and how targeted improvements to the existing investment adviser custody framework are necessary or appropriate. Then and only then should the Commission consider whether to repropose a rule in a state that is workable and affords market participants with the opportunity to accurately assess its implications and meaningfully comment.

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Please feel free to contact the undersigned with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger
Managing Director
Global Head of Government & Regulatory Policy

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[70] 88 Fed. Reg. at 14687–88; *see also id.* at 14761 ("The proposed rule affects … futures commission merchants registered with the CFTC[.]").

[71] *Hunter*, 711 F.3d at 159 (first quoting *Universal Interpretive Shuttle Corp. v. Wash. Metro. Area Transit Comm'n*, 393 U.S. 186, 193 (1968); and then quoting *Agri Processor Co. v. NLRB*, 514 F.3d 1, 4 (D.C. Cir. 2008)).

[72] *Id.* at 159–60 (quoting *Nat'l Ass'n of Home Builders v. Defs. of Wildlife*, 551 U.S. 644, 662 (2007)).