

SEC Proposes New Rule Regarding the Safeguarding of Client Assets

by David Tang and Michael Schmieder

On February 15, 2023, the Securities and Exchange Commission (the “SEC”) proposed changes that would amend and re-designate Rule 206(4)-2 (the “Custody Rule”) under the Investment Advisers Act of 1940 (the “Advisers Act”) as new Rule 223-1 (the “Safeguarding Rule”) under the Advisers Act.¹

The proposed Safeguarding Rule would, among other changes:

- Expand the reach of the Custody Rule beyond client funds and securities to include all “funds, securities, or other positions held in a client’s accounts,” including crypto assets, of which an SEC-registered investment adviser (“Adviser”) has custody;
- Expand the definition of custody to include discretionary authority to trade for clients’ accounts;²
- Require Advisers with custody of client assets to enter into a written agreement with, and obtain certain reasonable assurances from, qualified custodians to ensure clients receive certain standard custodial protections;
- Require Advisers with custody of client assets to segregate those assets by (i) titling or registering the assets in the client’s name or otherwise holding the assets for the client’s benefit, (ii) not commingling the assets with the Adviser’s or any of its related persons’ assets, and (iii) not subjecting the assets to any right, charge, security interest, lien, or claim of any kind in favor of the Adviser or its related persons or creditors, except to the extent agreed to or authorized in writing by the client;
- Expand the Custody Rule’s exception from the obligation to maintain client assets with a qualified custodian for certain privately offered securities to include certain physical assets, and modify the conditions for relying on this exception;
- Expand the availability of the Custody Rule’s audit provision as a means of satisfying the surprise examination and client notice requirements from pooled investment vehicles to any other entity;
- Amend the recordkeeping rule under the Advisers Act 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 SEC, its staff, and the public.

Related People

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Related Capabilities

- Investment Funds
- Investment Management

Dorsey Observations

The proposed Safeguarding Rule would significantly expand the scope and requirements of the Custody Rule. In view of the requirements of the proposed Safeguarding Rule, Advisers may wish to reassess their policies and procedures regarding the safeguarding of client assets, including assets that are not funds or securities. Dorsey's investment adviser compliance services are available to assist Advisers with their obligations related to the safeguarding of client assets.

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

² Notwithstanding the expanded definition of custody under the proposed Safeguarding Rule, an Adviser would not be subject to the surprise examination requirement if the Adviser has custody of client assets solely because the Adviser has discretionary authority with respect to those assets provided that client assets are maintained with a qualified custodian and the Adviser's discretionary authority is limited to instructing the qualified custodian to transact in assets that settle exclusively on a delivery versus payment basis.