MEMORANDUM

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TO: David A. Vaughan
SEC Division of Investment Management

FROM: Steven W. Stone

DATE: July 21, 2010

SUBJECT: Requests for Further SEC Staff Interpretations on Custody

On behalf of the SIFMA Private Client Committee Custody Working Group, we appreciate the Staff's willingness to consider our requests for further interpretive guidance under Rule 206(4)-2. The following draft guidance is presented as a mark-up of the SEC staff's current guidance. As always, we are available to discuss these matters or any questions you may have at your convenience.

1. Transfers Among Accounts & Pre-Authorized Transfers

II. Definition of Custody; Scope of the Rule

Question II.4

Q: Does an adviser have custody if it has authority to transfer client funds or securities between two or more of a client's accounts maintained with the same qualified custodian or different qualified custodians?

A: Under rule 206(4)-2(d)(2)(ii), an adviser has custody if it has the authority to withdraw client assets maintained with a qualified custodian upon the adviser's instruction to the custodian. We do not interpret the authority to withdraw assets to include the limited authority to transfer a client's assets between the client's accounts maintained at one or more qualified custodians if the client has authorized the adviser in writing to make such transfers and a copy of that authorization is provided to the qualified custodians, specifying the client accounts maintained with [~~qualified custodians. (Modified May 20,~~]**the qualified custodians. Such authorization may apply prospectively to any transfers made from time to time between the client's accounts and, for example, may take the form of an authorization specific to account transfers or an investment advisory contract under which the adviser's authority includes the ability to make such transfers. (Modified XXXX,** 2010.)

Question II.5

Q: Does an adviser have custody if it has authority to instruct the qualified custodian that maintains a client's account to remit the funds or securities from the account to the same client at his or her address of [~~records~~]**record**?

A: We do not interpret the authority to instruct the qualified custodian maintaining a client's account to remit the funds or securities from the account **from time to time** to the same client at his or her address of record as having custody if (1) the client has granted such authority to the adviser in writing and a copy of that authorization is provided to the qualified custodian, and (2) the adviser [has]**exercises** neither the authority to open an account on behalf of the client nor the authority to designate or change the client's address of record with the qualified custodian[. (Posted May 20,] **(unless the qualified custodian notifies the client of any such change of address at the client's old address of record).[1] (Modified XXXX, 2010.)**

Question II.6

Q. Does an adviser with limited authority to make pre-authorized transfers of client funds or securities to a third-party account at the same or another qualified custodian have custody?

A: We do not interpret the authority to withdraw assets (which could result in custody by an adviser) to include the limited authority of an adviser to make pre-authorized transfers of client funds or securities to an account of a third party if the following conditions are met: (1) the third party is not a related party of the adviser, (2) the client has provided to his or her qualified custodian signed, written instructions that specify the third party's name, account number, and qualified custodian, and (3) the client has provided the adviser with limited authorization in writing to transfer funds on the client's behalf from time to time to the specified third party account (as indicated in the written instructions to the qualified custodian), a copy of which is received by and reasonably acceptable to the qualified custodian. (Posted XXXX, 2010.)

2. Reasonable Belief of Statement Delivery

IV. Account Statements; Surprise Examinations

Question IV.1

Q: May account statements be delivered electronically?

[1] **Note that the suggested revisions are consistent with existing financial regulatory requirements designed to protect against improper or unauthorized changes of address. For example, broker-dealers must confirm customer requests for a change of address by notice to the customer at the customer's old address within 30 days of receiving a notice of the requested change. *See* 17 C.F.R. § 240.17a-3(17)(i)(B)(2). Similarly, banking regulators have issued guidance providing that banks should send confirmation of a customer request for a change of address to both the old and new address on record. *See* Federal Reserve System Supervisory Letter SR 0-11 (April 26, 2001); Office of Comptroller of the Currency Advisory Letter 2001-4 (April 30, 2001); Federal Deposit Insurance Corporation Financial Institution Letter 39-2001 (May 9, 2001); Office of Thrift Supervision CEO Letter No. 139 (May 4, 2001); and National Credit Union Administration Letter No. 01-CU-09 (September 2001)). Finally, credit and debit card issuers are required to notify the cardholder of a change of address request at the former address where there is a request for a replacement or additional card within 30 days of the change of address. *See* 12 C.F.R. §§ 41.91(c), 222.91(c), 334.91(c), 571.91(c), 717.91(c) and 16 C.F.R. § 681.2(c).**

A: Yes. Electronic delivery is permissible, if [~~(1) the client has given informed consent to receiving the information electronically; (2) the client can effectively access the electronically delivered information; and (3) evidence of the delivery is received~~]**the qualified custodian complies with the requirements of the Electronic Signatures in Global and National Commerce Act (or E-SIGN) or the Commission's guidance on electronic delivery**, [~~such as an email return-receipt or other confirmation that the information was accessed~~]**as applicable**. See Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, Release No. 33-7288 (May 9, 1996) [61 FR 24644 (May 15, 1996)]. These guidelines are available at www.sec.gov/rules/concept/33-7288.txt.

Advisers whose clients receive electronic statements from qualified custodians must still form a reasonable belief after due inquiry that the clients are receiving those statements. The adviser may satisfy this requirement by, for example, being copied on the email notifications of account statement postings sent to clients in addition to having access to client statements on the custodian's website, although this is not the exclusive means of forming that reasonable belief (footnote 21 of the Adopting Release). (Modified [~~March 5,~~]**XXXX,** 2010.)

Question IV.*x*

Q: Apart from getting copies of account statements delivered to clients, what are other ways in which advisers may satisfy the "due inquiry" requirement to establish a reasonable basis for believing qualified custodians are sending account statements directly to clients?

A: Investment advisers may satisfy the "due inquiry" requirement in order to form a reasonable belief in any of the following nonexclusive ways so long as the investment adviser appropriately responds to any "red flags" or other indications of irregularity that would call into question whether a qualified custodian is sending customer account statements to clients: (i) receipt of representations or warranties from qualified custodians to the effect that they are sending account statements to clients; (ii) receipt of periodic certifications from qualified custodians that they are sending account statements to clients; (iii) representations or warranties from clients that they understand they are to receive account statements directly from qualified custodians and that they will promptly advise the investment adviser if they do not receive such account statements; (iv) receiving from a qualified custodian an electronic notice specific to that advisor which confirms that statements have been sent to clients with a link to each of the client account statements or a listing of applicable client accounts; (v) sending periodic or episodic requests to clients asking them to alert the investment adviser if they have not received account statements; (vi) periodically confirming with selected clients that they have received account statements; or (vii) confirming that qualified custodians are independently subject to requirements under applicable law or regulation to send periodic account statements directly to clients. (Posted XXXX, 2010.)

3. Imputation of Custody for Registered Representatives

xxx. Licensed Representatives

Question xxx.x

Q: Would an adviser be deemed to have custody of client funds or securities where a related person (e.g., an employee) of the adviser is a registered representative of an unaffiliated broker-dealer that has custody of client funds and securities?

A: No. We would not consider an adviser to have custody of client funds or securities in this circumstance so long as the related person who is a registered representative of an unaffiliated broker-dealer does not, in connection with being a registered representative of the unaffiliated broker-dealer, receive client funds or securities (other than checks drawn by clients and made payable to third parties such as the unaffiliated broker-dealer or its carrying broker) or have the authority to withdraw client funds or securities maintained by the unaffiliated broker-dealer. (Posted XXXX, 2010.)

c: Ira Hammerman
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