

ICI VIEWPOINTS

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The SEC's Proposed Safeguarding Rule Will Cost Investors

By R.J. Rondini

Custodians play a vital role in financial markets, reinforcing trust and serving investors by safeguarding assets. Existing practices in the custody business are longstanding and function exceptionally well.

Yet the Securities and Exchange Commission (SEC) wants a [sweeping expansion](#) of its custody rule, which currently covers funds and securities managed by investment advisers. If adopted, the Commission's proposed amendments would disrupt the entire custodial ecosystem, driving up costs for investors and reducing their access to professional investment advice.

Basic services that all investors depend on would become more expensive, and liquidity and settlement efficiency in securities markets would weaken.

Introducing Unnecessary Complications

The SEC's proposed amendments would broaden its custodial oversight to include *all* assets in advisory accounts, including a host of financial instruments that aren't assets in the traditional sense. That creates serious complications because unlike funds and ordinary stocks and bonds, some financial instruments—such as direct loans, mortgages, and derivatives—are live contracts between buyers and sellers, making them extremely difficult to custody.

If the SEC adopts its proposal, custodians will likely refuse to service those financial instruments in advisory accounts, resulting in complex challenges and increased costs for investors.

Stifling Access to Emerging Markets

The SEC also risks driving away important custody and advisory services, going as far as to acknowledge so in its proposing release. Sadly, the Commission fails to grasp the harms that would bring to investors and overall markets.

For instance, custodians would likely turn away advisory assets invested in some emerging markets. That's because the proposal would force custodians to take on liability for central securities depositories (CSDs)—market utilities that clear transactions.

While that requirement wouldn't impact trading in developed markets like the US, it would in less stable markets, as custodians would likely not accept CSD liability in areas with significant geopolitical and other risks. If some custodians do accept that liability, the price to custody those emerging markets assets is likely to be multiples more expensive than it is today.

A Look Inside the Vault

- Verification of ownership
- Accounting and valuation
- Collection and distribution of income
- Trade processing
- Tax reporting

Cutting Off Important Market-Related Services

Finally, while the SEC's desire to improve the integrity of client assets is commendable, its obvious misunderstanding of custodians' business operations is problematic. The proposal would force custodians, namely banks and savings associations, to segregate client assets into individual accounts—a change that would be difficult, if not impossible, to implement.

The requirements would hinder custodians' ability to pool investors' deposits, a vital function that allows custodians to provide important market-related services, including short-term loans, overdrafts, and intraday liquidity to facilitate securities settlement. Consequently, basic services that all investors depend on would become more expensive, and liquidity and settlement efficiency in securities markets would weaken.

Understanding the Real-World Impact

While we appreciate the SEC's attention to existing rules given the evolution of financial markets, the current custody system is working well for investors. Unfortunately, the Commission has not demonstrated that the real-world costs of its proposal would outweigh any theoretical benefits.

The SEC needs to consider how the custody business operates and impacts everyday investors. If it doesn't, Americans seeking to invest with the aid of a professional will pay a steep price.

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