

## Policy Statement Released Concerning the Custody Rule for Massachusetts-Registered Investment Advisers

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In light of custody-related deficiencies identified by the Massachusetts Securities Division in recent examinations of Massachusetts-registered investment advisers, the Division released a Policy Statement on November 14, 2013 concerning compliance with custody and independent verification requirements. A copy of the Policy Statement is available [here](#).

The Policy Statement emphasizes that advisers are deemed to have custody of clients' assets, and are thus subject to additional regulatory requirements, in the following circumstances:

- A. if an adviser's supervised persons are appointed as executors, conservators or trustees of client accounts with authority to withdraw assets from such accounts (other than for deduction of advisory fees), even if the executorship, conservatorship or trusteeship arises as a result of a family or person relationship; and/or
- B. if an adviser directly deducts advisory fees from client accounts, unless the adviser complies with certain procedures.

While the SEC does not consider an adviser to have custody in (A) above, the Policy Statement stresses that the Division has not adopted the SEC's position. The Policy Statement states that the Division considers an adviser to have custody of client assets by virtue of a trustee (or other similar) relationship, regardless of a family or personal relationship: "The Division believes that a client who happens to be a family member or who has a personal relationship with an investment adviser's supervised person should be afforded the same protections otherwise provided to investors by the Massachusetts Uniform Securities Act and the regulations thereunder, including the independent verification provisions found in the custody rule."

The Policy Statement reminds advisers that the requirement for independent verification of custodial assets where advisory fee deduction directly from client accounts is the only sign of custody is waived only if the adviser complies with the following procedures:

- obtains written authorization from the client to deduct advisory fees from the account held with the qualified custodian; and
- sends the qualified custodian and client an invoice or statement of the amount to be deducted from the account each time a fee is directly deducted.

Documentation demonstrating compliance must be maintained and preserved. If an adviser does not adhere to these procedures, the adviser will be deemed to have custody and must annually undergo a surprise audit by an independent public accountant that is registered with the Public Company Accounting Oversight Board.

In November 2013, the Division also issued a preliminary report concerning examinations of investment advisers that switched from registration with the SEC to the Division which highlighted the deficiencies in compliance with the custody rule. A copy of the report is available [here](#). **Because of the Division's concern that custody creates a higher potential of investor harm, advisers that are not in compliance with the Massachusetts custody rule may face regulatory actions filed by the Division to enforce custody requirements.**

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