

June 17, 2019

**BUREAU POSITION ON CUSTODY REQUIREMENTS FOR INVESTMENT ADVISERS
WITH STANDING LETTERS OF AUTHORIZATION ARRANGEMENTS
ESTABLISHED BY A CLIENT AND QUALIFIED CUSTODIAN**

To Whom It May Concern:

The Pennsylvania Department of Banking and Securities (“Department”), Bureau of Securities Compliance and Examinations (“Bureau”), has received inquiries concerning custody requirements, if any, the Bureau would mandate for investment advisers, registered or required to be registered in Pennsylvania, when they use standing letters of authorization (SLOA) or other similar asset transfer instruction arrangements established by a client with a qualified custodian under which an investment adviser is authorized to withdraw client funds or securities held with a qualified custodian upon the investment adviser’s instruction to the qualified custodian.

Custody

An Investment Adviser with custody must be in compliance with all custody rules as outlined in the Pennsylvania Securities Act of 1972 and Regulations promulgated by the Department. For Pennsylvania registered investment advisers, this generally requires, notification to the Department, a net worth of \$35,000, an annual audited balance sheet filed with the Department, completion of an internal control report that includes an opinion of an independent certified public accountant and an annual surprise examination of client funds or securities by an independent certified public accountant.

Bureau Position

The Bureau takes the position that the use of SLOAs or similar arrangements by investment advisers constitutes custody. As a result, an investment adviser must denote that they have custody in Item 9 of Form ADV Part 1A. However, the Bureau will not require the investment adviser to comply with the requirements to maintain a net worth of \$35,000, file an audited balance sheet, completion of an internal control report or be subject to an annual surprise examination of client funds or securities by an independent certified public accountant, if the following conditions are met:

1. The client provides an instruction to the qualified custodian, in writing, that includes the client’s signature, the third party’s name, and either the third party’s address or the third party’s account number at a custodian to which the transfer should be directed.
2. The client authorizes the investment adviser, in writing, either on the qualified custodian’s form or separately, to direct transfers to the third party either on a specified schedule or from time to time.

3. The client's qualified custodian performs appropriate verification of the instruction, such as a signature review or other method to verify the client's authorization, and provides a transfer of funds notice to the client promptly after each transfer.
4. The client has the ability to terminate or change the instruction to the client's qualified custodian.
5. The investment adviser has no authority or ability to designate or change the identity of the third party, the address, or any other information about the third party contained in the client's instruction.
6. The investment adviser maintains records showing that the third party is not a related party of the investment adviser or located at the same address as the investment adviser.
7. The client's qualified custodian sends the client, in writing, an initial notice confirming the instruction and an annual notice reconfirming the instruction.
8. The investment adviser must include the client funds and securities that are subject to a SLOA that result in custody in Item 9 of Form ADV Part 1A and explain the arrangement(s) in Item 15 of Form ADV Part 2A. In addition, the investment adviser must specify in Schedule D, Miscellaneous Section, of Form ADV Part 1A and Item 15 of Form ADV Part 2A: (a) both the amount and number of clients included in the Item 9 custody figures solely because of the SLOA(s); and (b) attest that the investment adviser is complying with each of the requirements and conditions listed in this Bureau Position regarding SLOA arrangements.

Remedial Action

The Bureau understands that investment advisers, qualified custodians and their clients will require a reasonable time period to implement the procedures to comply with this Bureau Position. Unless additional circumstances exist, the Bureau will not recommend administrative action for an inaccurate Form ADV as it relates to custody and the use of a SLOA if Form ADV is properly updated within six months of the date of this letter.

On Behalf of the Commonwealth
Department of Banking and Securities,



Glenn R. Skreppen, Bureau Director
Bureau of Securities Compliance and Examinations