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## 17 CFR 275.206(4)-2 - Custody of funds or securities of clients by investment advisers.

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§ 275.206(4)-2 Custody of funds or securities of clients by investment advisers.

**(a) Safekeeping required.** If you are an investment adviser registered or required to be registered under section 203 of the Act ([15 U.S.C. 80b-3](#)), it is a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act ([15 U.S.C. 80b-6\(4\)](#)) for you to have custody of client funds or securities unless:

**(1) Qualified custodian.** A qualified custodian maintains those funds and securities:

- (i)** In a separate account for each client under that client's name; or
- (ii)** In accounts that contain only your clients' funds and securities, under your name as agent or trustee for the clients.

**(2) Notice to clients.** If you open an account with a qualified custodian on your client's behalf, either under the client's name or under your name as agent, you notify the client in writing of the qualified custodian's name, address, and the manner in which the funds or securities are maintained, [promptly](#) when the account is opened and following any changes to this information. If you send account statements to a client to which you are required to provide this notice, include in the notification provided to that client and in any subsequent account statement you send that client a statement urging the client to compare the account statements from the custodian with those from the adviser.

**(3) Account statements to clients.** You have a reasonable basis, after due inquiry, for believing that the qualified custodian sends an account statement, at least quarterly, to each of your clients for which it maintains funds or securities, identifying the [amount](#) of funds and of each security in the account at the end of the period and setting forth all transactions in the account during that period.

**(4) Independent verification.** The client funds and securities of which you have custody are verified by actual examination at least once during each calendar year, except as provided below, by an independent public accountant, pursuant to a written agreement between you and the accountant, at a time that is chosen by the accountant without prior notice or announcement to you and that is irregular from year to year. The written agreement must provide for the first examination to occur within six months of becoming subject to this paragraph, except that, if you maintain client funds or securities pursuant to this section as a qualified custodian, the agreement must provide for the first examination to occur no later than six months after obtaining the internal control report. The written agreement must require the accountant to:

- (i)** File a certificate on Form ADV-E (17 CFR [279.8](#)) with the Commission within 120 days of the time chosen by the accountant in paragraph (a)(4) of this section, stating that it has examined the funds and securities and describing the nature and extent of the examination;
- (ii)** Upon finding any [material](#) discrepancies during the course of the examination, notify the Commission within one business day of the finding, by means of a facsimile transmission or electronic mail, followed by first class mail, directed to the attention of the Director of the Office of Compliance Inspections and Examinations; and
- (iii)** Upon resignation or dismissal from, or other termination of, the engagement, or upon removing itself or being removed from consideration for being reappointed, file within four business days Form ADV-E accompanied by a statement that includes:
  - (A)** The date of such resignation, dismissal, removal, or other termination, and the name, address, and contact information of the accountant; and
  - (B)** An explanation of any problems relating to examination scope or procedure that contributed to such resignation dismissal, removal, or other termination.

**(5) Special rule for limited partnerships and limited liability companies.** If you or a related [person](#) is a general partner of a limited partnership (or managing member of a limited liability company, or hold a comparable position for another type of pooled investment vehicle), the account statements required under paragraph (a)(3) of this section must be sent to each limited partner (or member or other beneficial owner).

**(6) Investment advisers acting as qualified custodians.** If you maintain, or if you have custody because a related [person](#) maintains, client funds or securities pursuant to this section as a qualified custodian in connection with advisory services you provide to clients:

(i) The independent public accountant you retain to perform the independent verification required by paragraph (a)(4) of this section must be registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by, the Public Company Accounting Oversight Board in accordance with its rules; and

(ii) You must obtain, or receive from your related [person](#), within six months of becoming subject to this paragraph and thereafter no less frequently than once each calendar year a written internal control report prepared by an independent public accountant:

(A) The internal control report must include an opinion of an independent public accountant as to whether controls have been placed in operation as of a specific date, and are suitably designed and are operating effectively to meet control objectives relating to custodial services, including the safeguarding of funds and securities held by either you or a related [person](#) on behalf of your advisory clients, during the year;

(B) The independent public accountant must verify that the funds and securities are reconciled to a custodian other than you or your related [person](#); and

(C) The independent public accountant must be registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by, the Public Company Accounting Oversight Board in accordance with its rules.

(7) *Independent representatives.* A client may designate an independent representative to receive, on his behalf, notices and account statements as required under paragraphs (a)(2) and (a)(3) of this section.

(b) *Exceptions.* (1) *Shares of mutual funds.* With respect to shares of an open-end company as defined in section 5(a)(1) of the Investment Company Act of 1940 ([15 U.S.C. 80a-5\(a\)\(1\)](#)) ("mutual fund"), you may use the mutual fund's transfer agent in lieu of a qualified custodian for purposes of complying with paragraph (a) of this section.

(2) *Certain privately offered securities.* (i) You are not required to comply with paragraph (a)(1) of this section with respect to securities that are:

(A) Acquired from the issuer in a transaction or chain of transactions not involving any public offering;

(B) Uncertificated, and ownership thereof is recorded only on the books of the issuer or its transfer agent in the name of the client; and

(C) Transferable only with prior consent of the issuer or holders of the outstanding securities of the issuer.

(ii) Notwithstanding paragraph (b)(2)(i) of this section, the provisions of this paragraph (b)(2) are available with respect to securities held for the account of a limited partnership (or a limited liability company, or other type of pooled investment vehicle) only if the limited partnership is audited, and the audited financial statements are distributed, as described in paragraph (b)(4) of this section.

(3) *Fee deduction.* Notwithstanding paragraph (a)(4) of this section, you are not required to obtain an independent verification of client funds and securities maintained by a qualified custodian if:

(i) you have custody of the funds and securities solely as a consequence of your authority to make withdrawals from client accounts to pay your advisory fee; and

(ii) if the qualified custodian is a related [person](#), you can rely on paragraph (b)(6) of this section.

(4) *Limited partnerships subject to annual audit.* You are not required to comply with paragraphs (a)(2) and (a)(3) of this section and you shall be deemed to have complied with paragraph (a)(4) of this section with respect to the account of a limited partnership (or limited liability company, or another type of pooled investment vehicle) that is subject to audit (as defined in rule 1-02(d) of Regulation S-X (17 CFR [210.1-02\(d\)](#))):

(i) At least annually and distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) within 120 days of the end of its [fiscal year](#);

(ii) By an independent public accountant that is registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by, the Public Company Accounting Oversight Board in accordance with its rules; and

(iii) Upon liquidation and distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) [promptly](#) after the completion of such audit.

(5) *Registered investment companies.* You are not required to comply with this section (17 CFR [275.206\(4\)-2](#)) with respect to the account of an investment company registered under the Investment Company Act of 1940 ([15 U.S.C. 80a-1](#) to 80a-64).

(6) *Certain Related Persons.* Notwithstanding paragraph (a)(4) of this section, you are not required to obtain an independent verification of client funds and securities if:

(i) you have custody under this rule solely because a related [person](#) holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services you provide to

clients; and

(ii) your related [person](#) is operationally independent of you.

(c) *Delivery to Related Person.* Sending an account statement under paragraph (a)(5) of this section or distributing audited financial statements under paragraph (b)(4) of this section shall not satisfy the requirements of this section if such account statements or financial statements are sent solely to limited partners (or members or other beneficial owners) that themselves are limited partnerships (or limited liability companies, or another type of pooled investment vehicle) and are your related persons.

(d) *Definitions.* For the purposes of this section:

(1) *Control* means the power, directly or indirectly, to direct the management or policies of a [person](#), whether through ownership of securities, by contract, or otherwise. Control includes:

(i) Each of your firm's officers, partners, or directors exercising executive responsibility (or persons having similar status or functions) is presumed to control your firm;

(ii) A [person](#) is presumed to control a corporation if the person:

(A) Directly or indirectly has the right to vote 25 percent or more of a class of the corporation's voting securities; or

(B) Has the power to sell or direct the sale of 25 percent or more of a class of the corporation's voting securities;

(iii) A [person](#) is presumed to control a partnership if the [person](#) has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the partnership;

(iv) A [person](#) is presumed to control a limited liability company if the person:

(A) Directly or indirectly has the right to vote 25 percent or more of a class of the interests of the limited liability company;

(B) Has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the limited liability company; or

(C) Is an elected manager of the limited liability company; or

(v) A [person](#) is presumed to control a trust if the [person](#) is a trustee or managing agent of the trust.

(2) *Custody* means holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them. You have custody if a related [person](#) holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services you provide to clients. Custody includes:

(i) Possession of client funds or securities (but not of checks drawn by clients and made payable to third parties) unless you receive them inadvertently and you return them to the sender [promptly](#) but in any case within three business days of receiving them;

(ii) Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian; and

(iii) Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives you or your supervised [person](#) legal ownership of or access to client funds or securities.

(3) *Independent public accountant* means a public accountant that meets the standards of independence described in rule 2-01(b) and (c) of Regulation S-X (17 CFR [210.2-01\(b\) and \(c\)](#)).

(4) *Independent representative* means a [person](#) that:

(i) Acts as agent for an advisory client, including in the case of a pooled investment vehicle, for limited partners of a limited partnership (or members of a limited liability company, or other beneficial owners of another type of pooled investment vehicle) and by law or contract is obliged to act in the best interest of the advisory client or the limited partners (or members, or other beneficial owners);

(ii) Does not control, is not controlled by, and is not under common control with you; and

(iii) Does not have, and has not had within the past two years, a [material](#) business relationship with you.

(5) *Operationally independent:* for purposes of paragraph (b)(6) of this section, a related [person](#) is presumed not to be operationally independent unless each of the following conditions is met and no other circumstances can reasonably be expected to compromise the operational independence of the related person: (i) Client assets in the custody of the related [person](#) are not subject to claims of the adviser's creditors; (ii) advisory personnel do not have custody or possession of, or direct or indirect access to client assets of which the related [person](#) has custody, or the power to control the disposition of such client assets to third parties for the benefit of the adviser or its related persons, or otherwise have the opportunity to misappropriate such client assets; (iii) advisory personnel and personnel of the related [person](#) who have access to advisory client assets are not under common supervision; and (iv) advisory personnel do not hold any position with the related [person](#) or [share](#) premises with the related [person](#).

(6) *Qualified custodian* means:

**(i)** A bank as defined in section 202(a)(2) of the Advisers Act ([15 U.S.C. 80b-2\(a\)\(2\)](#)) or a savings association as defined in section 3(b)(1) of the Federal Deposit Insurance Act ([12 U.S.C. 1813\(b\)\(1\)](#)) that has deposits insured by the Federal Deposit Insurance Corporation under the Federal Deposit Insurance Act ([12 U.S.C. 1811](#));

**(ii)** A broker-dealer registered under section 15(b)(1) of the Securities Exchange Act of 1934 ([15 U.S.C. 78o\(b\)\(1\)](#)), holding the client assets in customer accounts;

**(iii)** A futures commission merchant registered under section 4f(a) of the Commodity Exchange Act ([7 U.S.C. 6f\(a\)](#)), holding the client assets in customer accounts, but only with respect to clients' funds and security futures, or other securities incidental to transactions in contracts for the purchase or sale of a commodity for future delivery and options thereon; and

**(iv)** A foreign financial institution that customarily holds financial assets for its customers, provided that the foreign financial institution keeps the advisory clients' assets in customer accounts segregated from its proprietary assets.

**(7)** *Related person* means any [person](#), directly or indirectly, controlling or controlled by you, and any [person](#) that is under common control with you.

[[75 FR 1484](#), Jan. 11, 2010]