

## Winston & Strawn Eliminates Custody Confusion

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Winston & Strawn attorney Michael Wu obtained no-action assurances from the staff of the Securities and Exchange Commission (SEC) under the Investment Advisers Act Custody Rule on behalf of firm client Madison Capital Funding LLC (“Madison”), a subsidiary of New York Life Insurance Company.

Rule 206(4)-2, often referred to as the Custody Rule, was amended in 2010 after the Madoff scandal to provide for tighter controls over the safekeeping of client funds and securities by investment advisers. As a result of the complexity of custody generally, and the hurried nature by which Custody Rule was revised after the Madoff debacle, the Custody Rule has been a great source of confusion and frustration in the investment management industry. The no-action letter obtained by Michael has eliminated some of this custody confusion in the syndicated loan area in which certain investment advisers offer services to their clients.

Madison is an SEC-registered investment adviser that is in the business of providing nonbank senior loans to middle-market companies. Madison organizes loan syndicates, which generally include Madison, its affiliates, and other bank and nonbank lenders, as well as institutional and sophisticated investors. Loan syndicates may include Madison’s advisory clients as well as non-clients. Madison often acts as administrative agent on behalf of the loan syndicate pursuant to a credit agreement. It establishes a single bank account in its own name as agent for the loan syndicate participants (the “Agency Account”) to facilitate the movement of cash among the various participants and borrowers. Madison, however, has no authority to determine how the cash is used, allocated, or disbursed, and it applies the terms of the credit agreement in its capacity as the administrative agent.

Because Madison has the ability to access the funds in the Agency Account, which includes funds of its clients as well as non-clients, the SEC indicated that Madison would be deemed to have custody. Additionally, because the Agency Accounts commingled all loan syndicate participants’ funds of clients and non-clients, this would violate the Custody Rule’s requirements to maintain custody funds in a separate account for each client under that client’s name or in accounts that contain only the adviser’s clients’ funds under the adviser’s name as agent for the client. Compliance with the Custody Rule would have been costly and burdensome and would have required Madison (and other investment advisers that offer syndicated loan products to their advisory clients) to completely revise its business model.

The relief provided was conditioned on a number of undertakings that Winston attorneys fashioned with Madison to permit Madison to both continue its syndicated loan advisory business and provide for safekeeping of client assets.

The SEC response is available [here](#).

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Michael Wu