Statement

Statement on Proposed Rules Regarding Investment Adviser Custody

Chair Gary Gensler

Feb. 15, 2023

Today, the Commission is considering a proposal to expand and enhance the role of qualified custodians when registered investment advisers custody assets on behalf of their investors. I support this proposal because, in using important authorities Congress granted us after the financial crisis, it would help ensure that advisers don't inappropriately use, lose, or abuse investors' assets.

The Commission's custody rule for investment advisers, first adopted in 1962, was last updated in 2009. Importantly, though, Congress granted us new authorities in 2010 in response to the financial crisis and Bernie Madoff's frauds. In particular, Congress gave us authority to expand the advisers' custody rule to apply to all assets, not just funds or securities.

These authorities are important, as investment advisers advise investors or funds with literally trillions of dollars of assets under management.[1] They advise hedge funds, pension and retirement funds, endowments, or the public via robo-adviser apps. Today's proposal would cover all asset classes that an adviser may custody, such as privately issued securities, real estate, and derivatives. Further, investors would benefit from the proposal's changes to enhance the protections that qualified custodians provide. Let me highlight four of these areas.

First, the proposal enhances the protections that investors receive through the custody process to help ensure that their assets are properly segregated, which helps protect their assets should the adviser or custodian go bankrupt. Segregating an investor's assets into an account with the investor's name on it currently is a standard best practice. Thus, the proposal requires advisers to properly segregate their investors' assets and obtain reasonable assurances from qualified custodians to do the same. Under the current rule, the 2009 rule, advisers and qualified custodians are required to segregate investors' funds and securities, and today's proposal would expand those protections to all assets. Further, advisers would be required to use a qualified custodian that provides bankruptcy remoteness, whereby investors' assets are protected in the event of insolvency or bankruptcy.

Second, the proposal requires, for the first time, that advisers and qualified custodians enter into written agreements with each other that help guarantee the custodian's protections. The written agreements would include, amongst other requirements, that qualified custodians undergo annual evaluations from public accountants, provide account statements, and provide records upon request.

Third, the proposal would enhance requirements for foreign financial institutions that serve either as qualified custodians or as sub-custodians to a qualified custodian. These new requirements for foreign financial institutions would explicitly include, among others, that they provide for segregation and bankruptcy remoteness. These enhanced requirements would help ensure that advisers meet their obligations to investors—regardless of where the qualified custodians or sub-custodians that they use are located.

Fourth, the proposal would make explicit that the custody rule's safeguards apply to discretionary trading—when an adviser would seek to buy or sell an investor's assets on behalf of an investor. This would make clear that advisers who trade an investor's assets cannot circumvent the custody rule and the safeguards it provides.

Let me now turn to crypto assets.

Make no mistake: Today's rule, the 2009 rule, covers a significant amount of crypto assets. As the release states, "most crypto assets are likely to be funds or crypto asset securities covered by the current rule." Further, though some crypto trading and lending platforms may claim to custody investors' crypto, that does not mean they are qualified custodians. Rather than properly segregating investors' crypto, these platforms have commingled those assets with their own crypto or other investors' crypto. When these platforms go bankrupt—something we've seen time and again recently—investors' assets often have become property of the failed company, leaving investors in line at the bankruptcy court.

Make no mistake: Based upon how crypto platforms generally operate, investment advisers cannot rely on them as qualified custodians.

Further, today's proposal, in covering all asset classes, would cover all crypto assets—including those that currently are covered as funds and securities and those that are not funds or securities. Thus, through this expanded custody rule, investors working with advisers would receive the time-tested protections that they deserve for all of their assets, including crypto assets, consistent with what Congress envisioned.

I'd like to thank the members of the SEC staff who worked on this proposal, including:

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[1] Our examinations program commits significant resources ensuring advisers are in compliance with the custody rule and verifying the existence of investor assets at custodians—a process called asset verification. In FY 2022, the SEC's Division of Examinations verified more than 2.1 million investor accounts, totaling over $2 trillion.