

Public Statement

Staff Statement on WY Division of Banking's "NAL on Custody of Digital Assets and Qualified Custodian Status"

Division of Investment Management Staff in Consultation with FinHub Staff

Nov. 9, 2020

The Staff of the Division of Investment Management (the "Staff"), in consultation with the FinHub Staff, issue this statement^[1] following the publication of a recent letter by the Wyoming Division of Banking that included the Wyoming Division of Banking's views relating to the definition of "bank" and "qualified custodian" under the Investment Advisers Act of 1940 (the "Advisers Act") and rule 206(4)-2 thereunder (the "Custody Rule").^[2]

The Wyoming Division of Banking letter seeks to address questions regarding custody of digital assets under federal law and state law by stating that a Wyoming-chartered public trust company is permitted to provide custodial services for digital and traditional assets under Wyoming law.^[3] For example, the letter states that the entity may serve as a "qualified custodian" under the Custody Rule based on the definition of "bank" under the Advisers Act. The letter further states that the Wyoming Division of Banking would not recommend an investigation or enforcement action to the Securities and Exchange Commission (the "Commission"). In this regard, the letter seeks to provide interpretive guidance on a critical component of the Custody Rule, the definition of a "qualified custodian."

The Wyoming Division of Banking letter recognizes that it is addressing issues of both federal and state law and expressly states that the letter "should not be construed to represent the views of the SEC or any other regulatory agency." The Staff is issuing this statement to encourage interested parties to engage with the Staff directly on the application of the Custody Rule to digital assets, including with respect to the definition of "qualified custodian" under the rule.^[4]

SEC-registered investment advisers have important regulatory obligations under the Custody Rule, and they are expected to exercise care with respect to client assets with which they are entrusted. Determining who qualifies as a qualified custodian is a complicated, and facts and circumstances based, analysis given the critical role qualified custodians play within this framework by safeguarding the client assets entrusted to investment advisers.^[5] The Commission has limited the types of financial institutions that may act as qualified custodians to those institutions that possess key characteristics, including being subject to extensive regulation and oversight, that help to ensure that client assets are adequately safeguarded.^[6]

The Staff has engaged extensively with investment advisers, custodians and other market participants who are interested in the application of the Custody Rule to digital assets.^[7] Our engagement has also centered on soliciting feedback on issues related to the development of staff recommendations to amend the Custody Rule. If you would like to let the Staff know your views regarding these issues, we are providing an email box as a convenient method for you to communicate with us; we continue to communicate through the following address: IMOCC@sec.gov and insert "Custody Rule and Digital Assets" in the subject line.

In particular, we have been interested in the following on the topic of qualified custodians:

- Do state chartered trust companies possess characteristics similar to those of the types of financial institutions the Commission identified as qualified custodians? If yes, to what extent?
- In what ways are custodial services that are provided by state chartered trust companies equivalent to those provided by banks, broker-dealers, and futures commission merchants? In what ways do they differ? Would there be any gaps in – or enhancements to – protection of advisory client assets as a result of a state chartered trust company serving as qualified custodian of digital assets or other types of client assets?
- How do advisers assess whether an entity offering custodial services satisfies the definition of qualified custodian in the Custody Rule? What qualities does an adviser seek when entrusting a client's assets to a particular custodian? Do the qualities vary by asset class? That is, are there qualities that would be important for safeguarding digital assets that might not be important for safeguarding other types of assets? If so, what qualities and why? Should the rule prescribe different qualities based on asset class, or should the rule take a more principles-based approach and allow advisers to exercise care in selecting a custodian?
- Are there entities that currently satisfy the definition of qualified custodian under the Custody Rule that should not be included within that definition because they do not meet the policy goals of the rule? If so, which ones and why? Conversely, are there entities that currently do *not* satisfy the definition of qualified custodian but should? If so, which ones and why?

Submissions in response to this request will be made publicly available, and persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. Please submit only information that you wish to make publicly available.

[1] This statement represents Staff views and is not a rule, regulation, or statement of the Commission. The SEC has neither approved nor disapproved its content. SEC Staff statements, like all SEC Staff guidance, have no legal force or effect: they do not alter or amend applicable law, and they create no new or additional obligations for any person.

[2] Investment Advisers Act of 1940, Pub. L. No. 76-768, 54 Stat. 847 (codified as amended at 15 U.S.C. 80b-1 – 88b-21 (2012); 17 CFR 275.206(4)-2. As relevant here, “qualified custodian” is defined in the custody rule as “a bank as defined in section 202(a)(2) of the Advisers Act 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),” and “bank” is defined in section 202(a)(2) to include “...(C) any other banking institution, savings association, as defined in section 1462(4) of title 12, or trust company, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency, and which is supervised and examined by State or Federal authority having supervision over banks or savings associations, and which is not operated for the purpose of evading the provisions of this subchapter ...”.

[3] Wyoming Division of Banking, “No-Action Letter on Custody of Digital Assets and Qualified Custodian Status” (Oct. 23, 2020), available at <http://wyomingbankingdivision.wyo.gov/home/pressreleases/twooceanno-actionletterdigitalassetcustodyqualifiedcustodianstatus>.

[4] The Commission and the Staff, in considering the requirements of the Custody Rule and any enforcement actions thereunder, are not bound by statements or views expressed by state regulators. This includes statements or interpretations regarding custody of digital assets as well as more traditional securities and whether any entity is a “qualified custodian.”

[5] With respect to one aspect of this analysis – whether any entity's business consists of exercising fiduciary powers similar to those permitted to national banks as required by the definition of “bank” – the Staff expects that it would consult with the staff of the Office of the Comptroller of the Currency.

[6] See Custody of Funds or Securities of Clients by Investment Advisers, Investment Advisers Act Release No. 2876 (May 20, 2009) [74 FR 25354 (May 27, 2009)], available at <https://www.sec.gov/rules/proposed/2009/ia-2876.pdf>, at note 4 (discussing the key characteristics of financial institutions that may act as qualified custodians).

[7] Written feedback we have received in response to the Staff's letter on Engaging on Non-DVP Custodial Practices and Digital Assets is available at <https://www.sec.gov/investment/engaging-non-dvp-custodial-practices-and-digital-assets>. The IM Staff Letter on Engaging on Non-DVP Custodial Practices and Digital Assets (Mar. 12, 2019) is available at <https://www.sec.gov/investment/non-dvp-and-custody-digital-assets-031219-206>. Comments are made publicly available to further a dialogue on these issues as the Staff prepares recommendations for amendments to the Custody Rule for Commission consideration. See, *also*, Securities and Exchange Commission Regulatory Flexibility Agenda, available at <https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202004&RIN=3235-AM32>.