BLOCKCHAIN ASSOCIATION

June 26, 2025

Via E-mail (crypto@sec.gov)

Commissioner Hester M. Peirce
Chair, Crypto Task Force
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-0213

Re: Written Input Regarding Investment Adviser Custody-Related Topics

Dear Commissioner Peirce:

Blockchain Association ("BA") submits this letter in response to Questions 21-23 and 27-29 of your February 21, 2025 statement, "There Must Be Some Way Out of Here" (the "RFI").[1] This letter addresses several topics concerning crypto asset custody by registered investment advisers ("RIAs") under consideration by the Crypto Task Force of the Securities and Exchange Commission (the "Commission").

BA is the leading nonprofit membership organization dedicated to promoting a pro-innovation policy environment for the digital asset industry. BA is composed of over 120 members, including leading software developers, infrastructure providers, investors, and others supporting the public blockchain ecosystem. BA works with its broad-based membership to achieve regulatory clarity and to educate policymakers, regulators, and the courts about how blockchain technology can pave the way for a more secure, competitive, and consumer-friendly digital marketplace. The content of this letter does not reflect the views of BA's entire membership. While a majority of BA members, including, in particular, most of those that are themselves RIAs, support the arguments made herein, these arguments should not be ascribed to each and every BA member company.

We commend Commissioner Peirce for releasing the RFI and the Commission for standing up the Task Force such that stakeholder views can be heard. In particular, we appreciate the Task Force's careful and deliberate consideration of how to address the challenges faced by firms seeking to innovate with crypto assets and blockchain technology while also working within the Commission's three-part mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.

We think the Task Force has an important opportunity to modernize the custody rule for RIAs. While the current custody rule applies only to securities and funds and this letter does not aim to expand its application to assets that are not securities, RIAs should ensure crypto assets are maintained under conditions substantially similar to those for crypto assets that are securities.

[1] *See* Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, There Must Be Some Way Out of Here (Feb. 21, 2025), https://www.sec.gov/newsroom/speeches-statements/peirce-statement-rfi-022125.

The current rule has impeded investor access to crypto assets because it is premised on an outdated custody model that pre-dates blockchain technology and other innovations from the last few decades. The Commission should modify this rule to give RIAs, as fiduciaries for their clients, the flexibility to choose the appropriate custodian and method of custody (which may be self-custody,[2] if appropriate safeguards are met) that offers the best balance of safety, cost, and ability for investors to participate in a particular crypto asset's distinct features and associated rights, taking into account their clients' particular investment objectives as well as evolving technology and industry practices. This principles-based approach would allow RIAs to keep pace with the development of new asset classes, technologies, and industry standards. The Commission can provide this flexibility while maintaining appropriate safeguards against theft, loss, conflicts of interest, or other harmful practices.

We begin this letter by summarizing the key challenges that the Commission's current RIA custody rule has posed for the investors and RIAs that desire to invest in crypto assets. We then provide more details on the alternative approach described above. We go on to provide responses to the RFI's overall custody-related questions (numbers 21 through 23) and its questions concerning investment adviser custody and other requirements (numbers 27 through 29).

Key Challenges Posed by the Existing RIA Custody Rule

Rule 206(4)-2 (the "RIA Custody Rule") under the Investment Advisers Act of 1940 (as amended, the "Advisers Act") specifies how RIAs must maintain customer funds[3] and securities.[4]

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[2] As used in this letter, the term "self-custody" means that the assets remain with the RIA (*i.e.*, the assets are held by the RIA directly) and are not custodied at a third-party custodian. It does not refer to individual self-custody by an investor where such investor does not rely on any third-party for custody purposes (*e.g.*, the investor retains their private keys and does not use an RIA or any other third-party for this purpose). The RIA custody rule permits self-custody of client assets by RIAs that are also qualified custodians, subject to certain additional requirements. 17 C.F.R. § 275.206(4)-2(a)(6). In practice, however, relatively few RIAs, with the exception of dual registrants, are qualified custodians. An RIA that is not a qualified custodian can self-custody certain privately offered securities, *id.* § 275.206(4)-2(b)(2), and, as noted above, the RIA custody rule does not apply to crypto assets that are not funds or securities, so such an RIA can also self-custody those assets. The private securities exception is relatively narrow, and there has been uncertainty over which crypto assets are funds or securities. Though we appreciate Commissioner Peirce's recent statement that "most currently existing crypto assets in the market are not [securities]," Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, New Paradigm: Remarks at SEC Speaks (May 19, 2025), https://www.sec.gov/newsroom/speeches-statements/peirce-remarks-sec-speaks-051925-new-paradigm-remarks-sec-speaks, some regulatory uncertainty remains in this regard. As a result of these factors, the RIA custody rule has resulted in less frequent use of self-custody arrangements by RIAs. RIAs should be afforded the flexibility to self-custody their clients' crypto assets where appropriate, consistent with their fiduciary duty, and subject to the safeguards as further discussed in BA's response to Question 21.

[3] The term "funds" is not defined under the Advisers Act and thus the scope of its application remains the subject of considerable discussion and speculation throughout the crypto asset industry. BA encourages the Commission, as part of its efforts to modernize the RIA Custody Rule, to address this uncertainty. BA notes that many of its members interpret the term "funds" to be limited to cash or cash equivalents, and supports a narrow definition that will provide regulatory clarity to RIAs and their clients.

[4] The RIA Custody Rule refers to "funds and securities," but Section 223 of the Advisers Act provides that "[a]n investment adviser registered under this subchapter shall take such steps to safeguard client *assets*

The rule, which the Commission adopted in 1962 and later amended in 2009, has not kept pace with advances in technology and new asset classes.[5] The current RIA Custody Rule poses particular challenges for RIAs investing in crypto assets because RIAs may not be able to:

- make certain investments in crypto assets consistent with client investment mandates without violating the RIA Custody Rule, thereby placing RIAs in the untenable position of choosing between compliance with the RIA Custody Rule or fulfilling the client's investment mandate (including maximizing performance through staking or participating in liquidity pools);[6]

- self-custody crypto assets even where (i) doing so would be appropriate or desirable under the particular circumstances and (ii) the RIA observes appropriate safeguards;

- engage crypto asset-native custodians that may be better positioned to custody crypto assets vis-à-vis traditional "qualified custodians" due to their longstanding expertise in crypto asset-specific security measures and infrastructures, but which otherwise do not fall within the current definition of a "qualified custodian";

- engage in staking, governance, and other on-chain activities that involve temporary immobilization of assets pursuant to smart contracts or other on-chain processes; and

- trade on crypto exchanges that require pre-funding in order to facilitate real-time, gross settlement of transactions.[7]

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over which such adviser has custody, including, without limitation, verification of such assets by an independent public accountant, as the Commission may, by rule, prescribe" (emphasis added). 15 U.S.C. § 80b-18b. As such, although the existing RIA Custody Rule does not apply to crypto assets that are not securities—and we do not advocate for the RIA Custody Rule to apply to such assets or for an expansive set of crypto assets to be considered securities—in this letter we have set out an asset-neutral and principles-based approach to custody that is designed to be appropriate for any crypto asset, regardless of its categorization.

[5] The challenges presented by the RIA Custody Rule are amply portrayed by the need for dozens of staff responses to FAQs since its adoption.

[6] RIAs have a fiduciary duty to act in the best interests of their client, taking into account the client's particular investment objectives and relevant circumstances. *See generally* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-5248, 84 Fed. Reg. 33669 (July 12, 2019), https://www.federalregister.gov/documents/2019/07/12/2019-12208/commission-interpretation-regarding-standard-of-conduct-for-investment-advisers ("Standard of Conduct for RIAs").

[7] During the last Administration, the Commission took the position, in its 2023 proposing release to amend and replace the current RIA Custody Rule, that the current RIA Custody Rule renders the market practice of pre-funding trades on crypto exchanges impermissible in cases where such exchanges are not themselves qualified custodians. *See* Safeguarding Advisory Client Assets, Release No. IA-6240, 88 Fed. Reg. 14672, 14689 (Mar. 9, 2023), https://www.govinfo.gov/content/pkg/FR-2023-03-09/pdf/2023-03681.pdf (the "Safeguarding Proposal"); *see also* Withdrawal of Proposed Regulatory Actions, Release Nos. 33–11377;

Proposed Alternative Approach to RIA Crypto Asset Custody Regulation

The policy objective of the RIA Custody Rule is to protect client assets from the risk of loss, theft, misappropriation or being subject to the financial reverses of the adviser. Historically, the RIA Custody Rule focused broadly on custody-related safeguards and was less prescriptive. It was not until 2003, in connection with a substantial overhaul of the RIA Custody Rule, that the "qualified custodian" concept was formally introduced to codify industry best practices at the time. Subject to certain exceptions, that has meant requiring an RIA to maintain its clients' funds and securities with a third-party custodian falling into a limited set of "qualified custodians." However, advances in technology, including blockchain technology, mean that the rule's goal can, in some cases, be met through other methods of custody. Permitting self-custody of crypto assets by an RIA that is not a qualified custodian, or custody with other types of third-party custodians beyond those that have traditionally served the securities markets, will in many instances achieve this goal. In addition, blockchain technology generally affords the Commission and other outside parties at least comparable means—relative to traditional financial market infrastructure—to detect and address any instances of loss, theft, misappropriation or commingling of assets by RIAs or other persons.

In light of these considerations, which we discuss in greater detail below, the Commission should allow RIAs to choose their custodians (from among a broader set of potential custodians) and method of custody in a manner that is reasonably designed to minimize the risk of theft or loss through appropriate safeguards, taking into account the costs to clients, the clients' investment objectives, the RIAs' fiduciary and contractual duties, and evolving technology and industry practices. Specifically, when appropriate disclosure and other safeguards discussed below are satisfied, an RIA should not be required to custody crypto assets at a third-party custodian if the RIA is not a qualified custodian. Rather, such an RIA, together with its client, should be permitted to choose between self-custody and third-party custody of a client's crypto assets—and, in the latter case, between traditional and crypto asset-native custodians—as appropriate or desirable under the particular facts and circumstances.

Innovations in the crypto industry have enabled individuals to hold their assets without reliance on third-party custodians and engage in transactions in a safe, disintermediated manner. Although third-party custodians can provide benefits such as bankruptcy remoteness for an RIA, mandating the involvement of a third-party custodian may, in some cases, reintroduce other risks (such as the custodian's operational risk) that technological advances may mitigate or obviate. We do not believe it to be the Commission's intent to expose investors to custodial risks unnecessarily, which can occur where a third-party custodian has not developed the appropriate technology to custody crypto assets or implemented best practices tailored to the custody of crypto assets, but is permitted to custody such assets because it meets the definition of a "qualified custodian."

Where an RIA elects to self-custody crypto assets for its clients, the RIA should (i) provide those clients with appropriate disclosures, (ii) obtain those clients' consent, (iii) employ appropriate safeguards (as discussed below in our response to Question 21) and (iv) determine

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34–103247; IA–6885; IC–35635, 90 Fed. Reg. 25531, 25531 (June 17, 2025), https://www.govinfo.gov/content/pkg/FR-2025-06-17/pdf/2025-11110.pdf (withdrawing the Safeguarding Proposal).

that there are reliable means for the Commission or an independent accountant to reconcile ownership and control of the assets against a third-party ledger, whether maintained on a centralized basis (such as with an issuer or transfer agent) or on a distributed ledger.[8]

Where an RIA elects to engage a third-party custodian to custody crypto assets, the RIA should confirm that such third-party custodian is subject to U.S. federal, U.S. state, or foreign regulation (for foreign assets) that requires (i) segregation of assets held for clients or customers from proprietary assets, (ii) bankruptcy-remote structures for such assets, and (iii) capital or other financial resources requirements. In addition, the RIA should otherwise conduct due diligence on the potential custodian, including its technological ability to custody crypto assets and support, as relevant, participation in crypto asset-native activities (*e.g.*, staking or the exercise of governance rights), to determine its suitability for the role.

Our proposed approach is designed to be principles-based and asset-neutral, in that it does not prescribe particular custodial practices based on the regulatory categorization of an asset. That is, custody practices should be determined based on practical considerations that are meaningful to investors (*e.g.*, cost, security, and the ability to support a particular crypto asset's distinct features and associated rights), as investors typically do not distinguish among assets based on regulatory status.[9] Accordingly, custody rules should meet investors where they are, instead of artificially limiting investment opportunities.[10] This approach also would permit RIAs to leverage technological advances and innovation in the crypto asset market and to adopt prudent and tailored safeguards for client assets based on their specific custody practices and circumstances, consistent with their fiduciary duty under the Advisers Act.

Responses to General Custody Questions

Below we provide responses to the RFI's overall custody-related questions (numbers 21 through 23).

> ***21: Should the Commission amend existing rules, propose new rules, or provide guidance to facilitate custody arrangements for crypto assets? If so, what rule amendments or new rules would be appropriate, and to which types of activities should they apply? Should the Commission propose any specific changes to its rules to accommodate the self-custody of crypto assets by entities registered with the Commission? If so, what conditions should apply to self-custody arrangements to mitigate any related risks? Should***

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[8] This type of independent verification requirement is consistent with best practices used during the annual financial audit of private funds and the Commission-led "surprise" examination and asset verification processes that exist today. *See* 17 C.F.R. § 275.206(4)-2(a)(4).

[9] As noted above, disagreement exists with respect to whether certain types of crypto assets constitute "funds or securities" for purposes of the Advisers Act. *See supra* note 2.

[10] Notwithstanding the Safeguarding Proposal, this approach is consistent with the SEC's longstanding position of neutrality with respect to the potential merits of various investments. *See, e.g.*, Mark T. Uyeda, Comm'r, U.S. Sec. & Exch. Comm'n, Statement on Proposed Rule Regarding the Safeguarding of Advisory Client Assets (Feb. 15, 2023), https://www.sec.gov/news/statement/uyeda-statement-custody-021523.

the requirements for crypto assets that are securities and those that are not differ?

The Commission should take a principles-based approach to crypto asset custody matters by:

1. recognizing that "custody" over crypto assets may be different than for traditional securities held via book entry at intermediaries or through possession of physical certificates;

2. permitting RIAs to determine which type of custodial arrangement (*e.g.*, self-custody vs. maintaining assets with a traditional or crypto asset-native custodian) makes most sense based on the particular crypto asset at issue and the client's investment objectives, as well as the RIA's fiduciary and contractual duties;

3. expanding the range of "qualified custodians" with respect to crypto assets to include state registered trust companies, state banks and other, appropriately registered crypto asset-native custodians, as such custodians have developed crypto asset-specific security practices that may be more effective at safeguarding crypto assets than those designed for traditional asset classes; and

4. encouraging RIAs to evaluate new technologies and emerging industry practices to determine which safeguards are most appropriate for them and their clients.

The Commission can achieve these four objectives through a combination of guidance and rule amendments, as discussed below.

The Commission Should Recognize that "Custody" in the Crypto Context May Be Different Than for Traditional Securities

The RIA Custody Rule defines "custody" to mean "holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them."[11] It provides three examples, which relate to (i) physical possession, (ii) authorization or permission to withdraw client funds or securities maintained with a custodian and (iii) capacity that gives the RIA or its supervised persons legal ownership or access to client funds or securities. Given technological differences and innovations, "holding" or being able to obtain "possession" of crypto assets may look different than for traditional securities. The Commission should work with market participants to develop guidance in this regard, particularly in light of evolving technology.[12] Additionally, the Commission should support innovations in the crypto asset space that are consistent with its policy goals and ensure that its regulations do not prevent market participants from engaging with such innovations.

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[11] 17 C.F.R. § 275.206(4)-2(d)(2).

[12] This guidance could, for example, consider whether the person(s) with "effective control" or the "ability to control" the relevant assets is properly considered as having custody over such assets.

The Commission Should Permit "Self-Custody" by All RIAs, Subject to Appropriate Safeguards, and Provide RIAs with the Flexibility to Choose the Appropriate Custody Arrangement for Client Assets Based on the Particular Circumstances

RIAs must safeguard their clients' assets and act in their clients' best interests. Requiring the use of a qualified custodian may impede an RIA's ability to invest in a manner that is consistent with its clients' best interests where no qualified custodian is able or willing to support a particular crypto asset in a safe and cost-effective manner. In certain cases, the RIA itself may be best positioned to custody a particular crypto asset. Indeed, as Chairman Atkins has acknowledged, "[m]any advisers and funds have access to self-custodial solutions that incorporate more advanced technology to safeguard crypto assets as compared to some of the custodians in the market."[13]

For example, an RIA may wish to assist a client with staking a particular crypto asset but be unable to find a qualified custodian that can adequately support such a strategy (*e.g.*, the available qualified custodians do not provide staking services for the asset). Similarly, third-party custodians (and in particular non-crypto asset native custodians) often are reluctant to retrieve "forked" or "airdropped" assets due to potential liability concerns and/or a lack of requisite technological capacity, which often needs to be developed, to support such assets. In other instances, a qualified custodian may be available, but the RIA's engagement of that custodian would not be in the client's best interests. For example, the RIA or one of its affiliates may be better positioned to custody a particular crypto asset for its client based on its own security and technology systems and could do so in an equally safe and potentially more cost-effective manner than the available third-party custodians, notwithstanding the fact that the RIA or its applicable affiliate is not a qualified custodian.

In order to enable RIAs to better support their clients and allow market participants to access crypto assets, the Commission should amend the RIA Custody Rule to permit all RIAs to choose the method of custody (*e.g.*, self-custody or third-party custody) and, if applicable, the third-party custodian (*e.g.*, traditional or crypto asset-native custodian) that makes the most sense for their clients, subject to appropriate safeguards that are consistent with the policy rationales that underpin the RIA Custody Rule.

Specifically, an RIA that is not a qualified custodian but would like to self-custody a client's crypto assets should be subject to the following additional safeguards:

1. The RIA must adopt and implement reasonably designed policies and procedures to establish and monitor its custody arrangements on an ongoing basis to ensure that they are effective in safeguarding client assets, taking into account developing market practices and technologies, as well as any other relevant considerations, as discussed further below;

[13] Paul S. Atkins, Chairman, U.S. Sec. & Exch. Comm'n, Keynote Address at the Crypto Task Force Roundtable on Tokenization (May 12, 2025), https://www.sec.gov/newsroom/speeches-statements/atkins-remarks-crypto-roundtable-tokenization-051225-keynote-address-crypto-task-force-roundtable-tokenization.

2. The RIA must obtain an independent financial and technical audit, and make the audit report available to the Commission upon request;

3. The RIA must fully disclose to its client the risks associated with self-custody at an entity that is not a qualified custodian;[14]

4. The RIA's client must affirmatively consent and opt in to such a self-custody arrangement; and

5. The RIA must be able to demonstrate that the Commission or an independent accountant would be capable of verifying the ownership and control of any given crypto asset.

We expect that these safeguards will ensure that such self-custody arrangements are used where appropriate and in light of the particular circumstances and the nature of the RIA and its client. Furthermore, as is the case today, an RIA that self-custodies client crypto assets would be subject to Commission examinations and asset verification processes to ensure no client assets (including crypto assets) have been lost or misappropriated, and all client assets are properly being held in custody. Similarly, an RIA that manages private funds and relies on the audit exception to satisfy the RIA Custody Rule will be subject to asset verification on an annual basis by the auditor if it elects to self-custody crypto assets. Furthermore, it is industry best practice that an independent auditor verifies the ownership and control of any given crypto asset.

We do not expect that all RIAs will elect to self-custody client assets, particularly given the potential risks and administrative and operational complexities involved in doing so (and that such complexities can, instead, be handled by a third-party custodian). However, the self-custody option should be available more broadly and each RIA should be able to choose the custody method that makes the most sense for its clients based on its particular circumstances and subject to the safeguards described above.[15]

<u>The Commission Should Expand the Range of "Qualified Custodians"</u>

The Commission should amend the RIA Custody Rule to expand the range of "qualified custodians" to include regulated entities that regularly provide custodial services for crypto assets today. Those entities should include a crypto exchange that is appropriately licensed or chartered and regulated at the federal or state level (*e.g.*, an exchange with a BitLicense) and subject to supervision with respect to, for example, the segregation and safekeeping of crypto assets. Under the current qualified custodian definition, RIAs must generally use multiple entities to transact on crypto exchanges (*e.g.*, a trust company custodian that is separate from the

[14] While such disclosure will vary among RIAs based on their particular facts and circumstances as well as the nature of the client, we expect such disclosures would cover topics including the RIA's custodial practices, as well as its security and other technological systems in place to safeguard assets. If the client is a private fund, the RIA would be required to provide these disclosures to fund investors.

[15] To the extent that the Commission has specific concerns not otherwise addressed in this letter with respect to RIAs that primarily serve retail investors, BA believes that such concerns (and related solutions) should not limit the flexibility provided to private funds under our proposed approach. We would be happy to discuss these issues further with the Commission.

exchange). While this structure is workable in some circumstances, it is less efficient than permitting the exchange itself to act as custodian. Confirming that appropriately regulated exchanges can be qualified custodians would provide more options for exchange operators and traders without negatively impacting investor protection.[16] In this regard, the Commission also should confirm that state-licensed entities that would not be considered qualified custodians today may serve as qualified custodians for crypto assets.[17]

Most crypto exchanges today require pre-funding for transactions (*i.e.*, a firm must pre-position sufficient assets at the exchange before that firm can trade), which enables the exchange to offer real-time settlement without any counterparty credit risk.[18] However, relatively few exchanges meet the current definition of a qualified custodian under the RIA Custody Rule, mostly because that definition was developed with traditional securities in mind.[19] Many crypto exchanges have developed effective security practices that are specifically designed for crypto assets, and these practices may be more effective at safeguarding client assets than those designed for traditional securities. In other words, these crypto exchanges have safeguards similar to those in place at the type of registrants that can be qualified custodians for traditional securities, so this approach would be consistent with the policy rationales underlying the qualified custodian requirement. Including crypto exchanges in the category of "qualified custodians" is important because RIAs would otherwise be limited to purchasing and selling crypto assets over-the-counter—which limits liquidity and potential trading counterparties, and may pose greater credit risks.[20] Limiting an RIA's ability to access crypto exchanges that require pre-funding for transactions may therefore impair the RIA's ability to seek best execution for its clients' transactions, which is inconsistent with the RIA's fiduciary duty.

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[16] To the extent the Commission has concerns regarding the indefinite safeguarding of crypto assets by crypto exchanges (rather than, *e.g.*, temporary safeguarding to facilitate transaction pre-funding), the Commission could consider requiring or recommending that an RIA set limitations on, for example, the amount of time it may custody a particular asset on an exchange and/or the percentage of assets under management that it may custody on any single or all such exchanges. We would be happy to discuss these considerations further with the Commission.

[17] Under the RIA Custody Rule, a state-licensed banking institution or trust company is a qualified custodian if, among other things, a substantial portion of its business consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks. *See also* Blockchain Ass'n, Comment Letter on Safeguarding Advisory Client Assets 12–14 (Release No. IA-6240; File No. S7–04–23; Fed. Reg. No. 2023–03681) (discussing state-chartered limited purpose trust companies and special purpose depository institutions).

[18] This point holds even though exchange trading counterparties typically are anonymous—where a trader knows *all* transactions are pre-funded, it need not worry (or may worry less) about the credit or settlement risks associated with all other traders on the platform.

[19] Crypto exchanges typically are not banks, savings associations, registered broker-dealers or futures commission merchants or foreign financial institutions that customarily hold financial assets for customers in separate accounts from proprietary assets. 17 C.F.R. § 275.206(4)-2(d)(6).

[20] When transacting over-the-counter with a known counterparty, a trader must concern itself with that counterparty's creditworthiness and trustworthiness. As noted above, that is not the case when transacting with anonymous counterparties on a fully pre-funded exchange.

<u>The Commission Should Encourage RIAs to Evaluate and Use, as Appropriate, New Technologies and Apply Appropriate Safeguards</u>

The Commission should take a principles-based approach that encourages RIAs (including RIAs that self-custody crypto assets) to evaluate new technologies and emerging industry practices in order to ensure that client assets are properly safeguarded in light of existing and emerging threats (*e.g.*, hacks). The Commission should not require the adoption of any specific custody-related technologies, as the technology in the crypto asset space is rapidly evolving and current best practices could soon become stale.

RIAs should be permitted to evaluate industry best practices to determine whether any changes to their practices are appropriate in light of their particular custody arrangements and customer base. Among other matters, the Commission should encourage an RIA to consider, as part of its evaluation:

- Whether it or its custodian has appropriate policies, procedures, and controls in place to address the potential risks associated with holding private keys (*e.g.*, measures to generate, use, and protect private keys from being used to make unauthorized or accidental transfers and measures that protect private keys from being corrupted, lost or destroyed, such as through clearly defined user roles and permissions (administrator, user/trader, auditor), multi-factor authentication ("MFA"), access logs, performance monitoring, etc.);

- Whether it or its custodian has appropriate policies and procedures in place to regularly test the effectiveness of cybersecurity controls;

- Whether it or its custodian has appropriate policies and procedures in place to respond effectively to security incidents, such as service disruptions or unauthorized access;

- Whether it or its custodian has appropriate policies and procedures in place to address business continuity and disaster recovery (including appropriate succession planning policies and procedures), and to ensure systems availability and functionality, in the event of a security incident or other adverse event;

- Whether it or its custodian has appropriate policies and procedures in place to manage unusual events (*e.g.*, blockchain malfunctions, airdrops and blockchain forks, slashing events, court-mandated freezes, a custodian's bankruptcy or similar proceeding, etc.);

- Whether it provides adequate disclosures about the risks of investing in crypto assets (similar to disclosures provided for other assets but appropriately modified to address specific risks and considerations with respect to the crypto asset market) as well as the specific terms of its custodial arrangements; and

- Whether it or its custodian has in place appropriate periodic testing of the foregoing, as appropriate.

22: Public, permissionless blockchains are being used to tokenize permissioned assets. To the extent the custody rules for broker-dealers, investment advisers, and investment companies are implicated, how should the Commission differentiate between native crypto assets of permissionless blockchains and tokenized permissioned assets? Does either type of crypto asset present greater risks of theft or loss?

Market participants should be able to invest in native crypto assets of permissionless blockchains and tokenized permissioned assets, and their RIAs should be able to assist them in doing so (*e.g.*, by custodying such assets) in a manner consistent with their fiduciary duty and such clients' best interests. The Commission's custody rules should not prescriptively differentiate between these types of assets and the Commission should maintain its position of neutrality with respect to the potential merits of various investments.

That being said, market participants and RIAs should recognize that the risk profiles of these types of assets may vary. For example, a tokenized permissioned asset may have transfer or other restrictions coded into the relevant smart contract, which could present operational or liquidity risks, depending on the particular restrictions or the authorities that the developer of the smart contract retains. On the other hand, such permissions could support greater security, again based on the particular nature of the permissions. Native crypto assets of permissionless blockchains, by definition, are not subject to those types of restrictions, but also can be transferred (potentially irrevocably) to nearly anyone with access to the blockchain. Given the wide variety of blockchains and crypto assets (both permissioned and permissionless), the appropriate approach is for each market participant (and their RIA) to evaluate the relative benefits and risks of any particular crypto asset on an instrument-by-instrument basis.

23: Are there commonly accepted practices and standards for auditing and accounting for crypto asset investments and transactions, including those related to valuation? How about with respect to verifying the existence and valuation of crypto assets, both among auditors and attestation providers (including non-accountant providers)? Should the Commission propose additional or specific requirements to address the unique nature of crypto assets?

Although no formal industry standards currently exist (akin to a standard like GAAP or IFRS), there are emerging practices and standards for, among other matters, (i) auditing and accounting of crypto asset investments and transactions and (ii) verifying the existence and valuation of crypto assets.

Notably, the Financial Accounting Standards Board ("FASB") issued an accounting standards update (the "Update") in December 2023 requiring entities to measure crypto assets at fair value separate from other intangible assets during each reporting period and recognize any changes from remeasurements of the fair value of crypto assets in an entity's income statement.[21]

[21] *See* Fin. Acct. Standards Bd., *Acct. Standards Update No. 2023-08: Intangibles—Goodwill and Other—Crypto Assets (Subtopic 350-60): Accounting for and Disclosure of Crypto Assets* (Dec. 2023), https://fasb.org/page/ShowPdf?path=ASU%202023-08.pdf&title=ACCOUNTING%20STANDARDS%20UPDA

Prior to the Update, which is effective for fiscal years beginning after December 14, 2025, crypto assets were treated as "indefinite-lived intangible assets" that are typically only tested annually for impairment to value (without accounting for any increases to value).

In addition, the Public Company Accounting Oversight Board ("PCAOB") has advocated for the development of crypto asset-specific risk assessment procedures and internal controls[22] as well as for the use of tools to support audits of crypto assets.[23] For example, auditors are increasingly using blockchain explorers to verify transactions and the existence of acquired crypto assets. Industry groups such as the American Institute of Certified Public Accountants ("AICPA") have also issued guidance regarding the auditing and accounting for crypto asset investments and transactions. Certain other industry groups, such as the Blockchain Security Standards Council, have also been recently formed for the express purpose of establishing appropriate security standards and audit frameworks for the blockchain industry.

We encourage the Commission to work with market participants and other stakeholders (*e.g.*, FASB, PCAOB, and AICPA) to better understand emerging best practices and consider how its regulations and guidance can best align with, accommodate, and further develop such practices. We expect there to be many areas where commonly accepted standards will be beneficial, including, for example, with respect to accounting for staking rewards (*e.g.*, whether rewards are revenue under ASC 606 or other income, and the appropriate timing at which to recognize such awards and the measurement basis) and the classification of wrapped tokens (*e.g.*, whether wrapped tokens that provide a 1-for-1 claim on an underlying crypto asset should follow fair value under ASC 350-60 or be treated as asset-referenced/derivative instruments).

Responses to Questions Concerning Investment Adviser Custody and Other Requirements

Below we provide responses to the RFI's questions concerning investment adviser custody and other requirements (Questions 27 through 29).

27: What challenges do registered investment advisers ("RIAs") face in complying with the Investment Advisers Act of 1940 ("Advisers Act") as it relates to investments in crypto assets that are securities? What common practices, if any, have developed to address these challenges?

As described in this letter, RIAs face considerable challenges in complying with the RIA Custody Rule as it applies to crypto assets today. RIAs must act in a client's best interest and exercise reasonable care and diligence in providing services in connection with the client's investment goals, but the current RIA Custody Rule, in mandating the use of a narrowly-defined

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TE%202023-08%E2%80%94Intangibles%E2%80%94Goodwill%20and%20Other%E2%80%94Crypto%20Assets%20(Subtopic%20350-60).

[22] *See* Pub. Co. Acct. Oversight Bd. , *Audits Involving Cryptoassets*, https://pcaobus.org/Documents/Audits-Involving-Cryptoassets-Spotlight.pdf (last visited Apr. 2025)

[23] *See* Pub. Co. Acct. Oversight Bd., *Spotlight: Inspection Observations Related to Public Company Audits Involving Crypto Assets* (June 2023), at 11–12, https://pcaobus.org/documents/crypto-assets-spotlight.pdf.

set of qualified custodians, may prevent RIAs and their clients from fully benefitting from and capturing the economic benefits of crypto assets.

As an initial matter (and as noted above) the current RIA Custody Rule mandates that client assets be maintained at a qualified custodian unless an exception applies. The Commission has enforced this obligation against firms for failing to hold crypto assets at a qualified custodian.[24] The current inability of RIAs that are not qualified custodians to self-custody crypto funds or securities or maintain them at crypto asset-native custodians that are not qualified custodians is a problem in part because, today, there are relatively few entities that are qualified custodians and capable of supporting a broad range of crypto assets with distinct features and associated rights.[25] For example, non-crypto asset-native custodians often are reluctant to retrieve "forked" or "airdropped" assets due to potential liability concerns and/or a lack of requisite technological capacity to support such assets. Additionally, many custodians offer somewhat limited support for certain crypto asset-native activities, such as using assets in governance or DeFi applications, or staking. Where such a custodian does support staking, those limitations may be undesirable for RIAs (*e.g.*, the custodian offers their own staking solution and only supports staking through that solution, the custodian limits liability for the failure of staking solutions, etc.). Moreover, the current inability of RIAs to custody certain assets in any manner other than with a qualified custodian may conflict with an RIA's ability to best comply with its duties or obligations to clients. In light of these challenges, and as described above, the Commission should amend the RIA Custody Rule to permit custody of crypto assets by crypto asset-native custodians and RIA self-custody of crypto assets more broadly, consistent with the safeguards discussed above.

Subject to appropriate safeguards, the Commission also should ensure that RIAs are able to participate in crypto asset-native activities without violating their obligations under the RIA Custody Rule. The RIA Custody Rule poses challenges for RIAs seeking to engage in crypto asset-native activities with client assets (*e.g.*, staking and validating, engaging in governance activities for a protocol, providing liquidity in an automated market maker protocol, or interacting with DeFi protocols, such as a lending/borrowing protocol). Participation in such activities is often in the clients' best interests because, for example, they may enable a client to earn additional returns without outsized risk. However, such activities can result in the relevant assets being temporarily immobilized via smart contract or some other on-chain mechanism, which could raise questions under the current RIA Custody Rule around whether immobilization is viewed as causing the asset to leave the "custody" of the custodian. For example, when a client stakes assets to a validator node on a particular blockchain, those assets do not move and their ownership does not change, but they are "locked" (*i.e.,* they typically cannot be transferred or used for other transactions for a specified period of time, often referred to as the unbonding

[24] *See SEC Charges Crypto-Focused Advisory Firm Galois Capital for Custody Failures*, SEC (Sept. 3, 2024), https://www.sec.gov/newsroom/press-releases/2024-111 (finding that Galois Capital failed to ensure that certain crypto assets held by the private fund that it advised were maintained with a qualified custodian).

[25] *See, e.g.*, Safeguarding Proposal, 88 Fed. Reg. at 14739-40 (surveying the availability of crypto custodians in 2023).

period).[26] The Commission should view the RIA or third-party custodian as maintaining custody over the relevant crypto asset in these circumstances given the asset remains with the RIA or custodian (albeit, subject to a temporary technological transfer limitation).[27]

Accordingly, an RIA's participation in such crypto asset-native activities, where such participation is consistent with the best interests of an RIA's clients, should not contravene the RIA Custody Rule. This approach to custody matters would provide RIAs with the necessary flexibility to use crypto assets effectively in furtherance of their clients' best interests and specified investment goals and objectives. Although these activities can expose investors to risks—such as risks of the relevant smart contract being hacked—it is better to allow RIAs to address those risks in a tailored fashion, such as through a risk analysis of the relevant technology, than to apply a blunt prohibition by viewing such activity as a violation of the RIA Custody Rule.

a. Could best execution or recordkeeping obligations, or compliance with Form ADV or Form PF disclosure requirements, be clearer in the crypto asset context?

An RIA's duty of care includes a duty to seek the best execution of a client's transactions with the goal of maximizing value for the client under the particular circumstances occurring at the time of the transaction. In so doing, the RIA must consider all relevant market conditions, not just the costs associated with a particular transaction.[28] Consistent with this requirement, the Commission should clarify that RIAs may, in fulfilling their duty to seek best execution, consider the unique features of the crypto asset markets (*e.g.*, gas fees, order routing or execution methods on different DeFi protocols, etc.).[29]

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[26] Participation in crypto asset-native activities carries the risk of assets being lost through, in the case of staking, slashing events or cyberattacks. These risks, however, are similar in many respects to those faced by traditional qualified custodians, which, for example, are also subject to hacks and other cyberattacks. The existence of such risks should not preclude an RIA from deploying client assets into such activities, provided that doing so is consistent with the RIA's fiduciary duty and the client's investment objectives.

[27] In this regard, the Commission should consider providing guidance confirming that blockchain nodes, validators, miners and similar entities are not included as custodians where such applications are used, but the relevant assets do not leave the RIA's or third-party custodian's custody and their ownership does not change. Relatedly, the Commission should consider providing guidance confirming that the providers of software that enables users to create and maintain a self-custody wallet also are not custodians. We would be pleased to discuss these matters with the Commission in more detail.

[28] *See* Standard of Conduct for RIAs, 84 Fed. Reg. at 33674–75.

[29] *See, e.g.*, *What are gas fees?*, COINBASE , https://www.coinbase.com/learn/crypto-basics/what-are-gas-fees (last visited Apr. 20, 2025) (discussing gas fees); *What are Ethereum Layer-2 blockchains and how do they work?*, COINBASE, https://www.coinbase.com/learn/crypto-basics/what-are-ethereum-layer-2-blockchains-and-how-do-they-work (last visited Apr. 20, 2025) (discussing Layer-2 solutions for reducing transaction fees and network congestion).

The Commission should also consider holistic updates to the RIA recordkeeping requirements under the Advisers Act (the "RIA Books and Records Rule")[30] in order to take into account the unique features of crypto assets. For example, the Commission could clarify that the RIA Books and Records Rule permits the use of distributed ledgers to satisfy certain recordkeeping obligations (*e.g.*, blockchains provide on-chain transaction history).[31]

b. *Do any crypto asset characteristics or market structures place advisory client crypto assets at a greater or different risk of theft, loss, or misappropriation? If so, how can those risks be addressed?*

Crypto asset markets present different (though not necessarily greater) risks than the markets for traditional securities. Examples of potential risks that are more prevalent in crypto asset markets, particularly on non-permissioned blockchains, include errors resulting in funds being sent to the wrong wallet or the potential loss of private keys and seed phrases. Other risks, however, manifest in both markets, including risks of theft, loss or misappropriation resulting from cybersecurity breaches, disruptions to critical systems and networks, and misappropriation by RIA personnel.[32] Decentralized networks offer greater mitigation against these and other risks given that these networks are open, transparent, and are not subject to any one person's or entity's unilateral control. Other risks may be less prevalent (or better mitigated) in crypto asset markets. For example, certain crypto asset market structures may better mitigate counterparty risk (*e.g.*, credit risk) based on the atomic settlement of transactions minimizing time exposure to counterparties.

The Commission should not mandate particular methods of managing these risks. Instead, the Commission should require RIAs, consistent with their obligations under Rule 206(4)-7 under the Advisers Act, to have in place appropriate policies and procedures to manage such risks. Such policies and procedures should be appropriately tailored based on, among other considerations, the suitability of adopting certain best industry practices as part of the RIA's engagement of qualified custodians and/or self-custody arrangements, advances in crypto technology, and the specific risks and vulnerabilities associated with the individual blockchains or networks on which relevant crypto assets are recorded.

28: Can RIAs trade, stake, vote, or otherwise participate without moving crypto assets outside a qualified custodian? Should the Commission amend the existing RIA custody rule to provide an exception to allow RIAs to move client crypto assets temporarily out of qualified custodial arrangements to

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[30] 17 CFR § 275.204-2.

[31] In this regard, we were pleased to see Staff of the Commission's Division of Trading and Markets provide guidance acknowledging that transfer agents may use distributed ledger technology. *See Division of Trading and Markets: Frequently Asked Questions Relating to Crypto Asset Activities and Distributed Ledger Technology* (May 15, 2025), https://www.sec.gov/rules-regulations/staff-guidance/trading-markets-frequently-asked-questions/frequently-asked-questions-relating-crypto-asset-activities-distributed-ledger-technology.

[32] With respect to misappropriation by an RIA, we note that this is a risk even if assets are held at a qualified custodian (that is, not self-custodied). At least for private funds, one of the significant protections against misappropriation—for any type of asset—is the annual audit exception that private funds rely on to satisfy their RIA Custody Rule obligations.

engage in staking, voting, or other novel participatory features of crypto assets? If so, should that exception be subject to time limits or other limitations or requirements?

As discussed in our response to Question 27, the process of staking, voting or participating in other on-chain activities may result in the temporary immobilization of crypto assets via smart contracts or other on-chain mechanics. Given that RIAs have a fiduciary duty to their clients and must make informed decisions regarding client investments based on the clients' investment goals and objectives, the RIA Custody Rule should not be applied to limit the ability of RIAs to trade, stake, vote, or otherwise participate in on-chain activities when in the best interests of clients and accompanied by appropriate safeguards.

29: What clarifications, if any, are needed in the Advisers Act regulations to address the cold or hot storage of crypto assets held in custody on behalf of a client?

a. What requirements, if any, should the Commission consider for the custody of crypto assets held in each type of wallet on behalf of a client? Should the requirements be the same for both types of wallets?

The RFI references two general categories of storage options for crypto assets: "hot" storage (*i.e.*, storage that is connected to the internet) and "cold" storage (*i.e.*, offline storage, often through a physical device akin to a thumb drive). In general, cold storage may reduce certain vulnerabilities (*e.g.*, hacks) given assets in cold storage are not connected to the internet. However, moving assets from cold to hot storage in a safe and secure manner takes time and market participants may not be able to transact as quickly as desired, including in times of market stress or dislocations. Hot storage, on the other hand, potentially subjects assets to heightened cyber risks because the private key storage mechanism is connected to the open internet, but allows an investor to more quickly react to market events.

The Commission should provide RIAs with flexibility to maintain client assets in any combination of cold and/or hot storage as they reasonably deem appropriate based on, as applicable, their and their clients' specific trading activity and investment strategies, provided that the RIA implements appropriate cybersecurity safeguards. In this regard, the Commission should require RIAs to have effective enterprise risk management programs covering custodial risks, which may include, among others and as relevant and appropriate under the particular facts and circumstances, the following elements: (i) policies and procedures to identify, mitigate, and prevent hacks (which is particularly relevant with respect to hot storage, as described below) and similar threats; (ii) access management policies and procedures; (iii) detection, response and investigation management; (iv) business continuity, disaster recovery and resolvability planning; and (v) key management. While choosing the appropriate storage method is important, it represents but one line of defense that RIAs should take into account with respect to their risk management programs. And, of course, an RIA should also ensure that it complies with the additional safeguards discussed in our response to Question 21 in the event that it elects to self-custody client crypto assets.

b. ***How would a requirement to maintain custody of some or all crypto assets in either cold or hot storage affect an adviser's ability to transact in those crypto assets or otherwise implement its investment strategy?***

Please see our response to Question 29(a). BA does not believe that mandating the adoption of one type of storage over another is appropriate and the Commission should not be prescriptive in this regard. It also would be inappropriate to conclude that, for example, cold storage is "safer" in all circumstances than hot storage, given the other elements that comprise effective risk management in the crypto market. Instead, RIAs should evaluate which combination of storage and other safeguarding arrangements is most appropriate for them and their clients based on their particular circumstances and as consistent with their fiduciary duty. However, as described above, RIAs should have policies and procedures in this regard, including with respect to private key management and disaster recovery. RIAs should also periodically evaluate such policies to ensure they remain fit for purpose.

c. ***What means are available to mitigate the risks related to maintaining crypto assets in hot storage?***

The crypto asset market continues to innovate new ways to manage risks, including specific vulnerabilities associated with hot storage (*e.g.*, vulnerability to hacks and similar threats). The recent attack on Bybit highlights the need for continued enhancements to security with respect to crypto asset storage.

In addition to the list of considerations that we propose in our response to Question 21 for custodians to evaluate, custodians could adopt certain safeguards including but not limited to the following:

- Use of dedicated signing devices and hardware wallets for all signers;
- Use of multi-party computation (MPC) or multi-sig wallets for private keys to reduce the risk of private keys being subject to a single point of failure (and building in delays between individual members signing/approving a transaction);
- Periodic assessments of the efficacy and security of third-party tools;
- Use of multi-factor authentication (MFA) to require users to be authenticated through multiple independent verification methods before engaging in a transaction;
- Establishing governance frameworks that require multi-party approval for critical operations;
- Use of encryption to enhance security;
- Limiting access controls to hardware; and
- 24x7 security monitoring and routine independent audits.

The Commission should encourage the continued development and incorporation of best industry practices where possible for both hot and cold storage.

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We appreciate the opportunity to provide feedback to the Crypto Task Force and the Commission more broadly on these important topics. The BA staff and our counsel are available to meet and discuss these matters with the Commission and to respond to any questions.

Respectfully submitted,

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