

Memorandum

The SEC Proposes to Modernize Custody Rules Under the Advisers Act and Investment Company Act

October 13, 2026

If observers thought the end of the SEC's fiscal year in September would bring a moment of rest for SEC staff (and for market participants) following a number of recent rulemakings, policy initiatives and staff guidance,¹ the SEC showed that its foot remains fully on the gas. Already having made noteworthy progress on its ambitious agenda to modernize the regulatory framework, on October 1st, the SEC published a proposed rulemaking (the "Proposal") to modify and redesignate the Advisers Act Custody Rule (Rule 206(4)-2) and also revise various rules under Section 17(f) of the Investment Company Act (collectively, the "Custody Rules"). If adopted, the Proposal would rationalize other elements of the existing Custody Rules to address persistent problems faced by registered investment advisers ("RIAs") and by registered investment companies and business development companies ("Regulated Funds").

At its core, the Proposal would bring about a modernization of the Custody Rules, including codifying previous SEC staff no-action letters and guidance, to solve historic compliance challenges for asset managers, including private fund sponsors. The Proposal also establishes a new framework permitting RIAs to self-custody crypto assets² under specified conditions (with board oversight for Regulated Funds) and adds U.S. State trust companies to the universe of custodians with which crypto assets can be held. Finally, the Proposal addresses disclosure, reporting, and recordkeeping requirements, and solicits extensive public comment on decentralized finance ("DeFi") activities and crypto trading platforms, among other topics.

Notably, and in line with the overall tenor of recent SEC rulemaking under the leadership of Chairman Atkins, the Proposal does not include many of the deeply problematic changes that had been proposed in the 2023 Safeguarding Proposal, which would have imposed new onerous requirements for safeguarding client assets, expanded the scope of assets subject to the Advisers Act Custody Rule and further conditioned the privately

¹ See, for example, our recent alerts on: "[SEC Watch: Monthly Takeaways for Asset Managers - October 2026](#)"; "[Responsible Retailization, Round One: Key Takeaways from the SEC's Proposals to Expand Regulated Fund Access to Private Markets](#)"; "[SEC Joint Statement on Valuation of Private Assets](#)"; "[SEC Issues Innovation Exemption for Tokenized Securities Venues: A New Framework for Onchain Trading of Tokenized NMS Stocks](#)"; and "[SEC Watch: Monthly Takeaways for Asset Managers - September 2026](#)."

² Under the existing Advisers Act Custody Rule, an RIA, subject to certain exceptions, is required to hold "funds and securities" with a "qualified custodian," which is limited to a bank or savings association, broker-dealer, futures commission merchant, or certain foreign financial institutions. Under the Investment Company Act Custody Rule, "securities and similar investments" must be maintained with certain specified custodians that include banks, broker-dealers that are members of a national securities exchange, and securities depositories, among others. The Proposal notes the Custody Rules requirements with respect to crypto assets are limited to crypto assets that are "funds or securities" with respect to RIAs or that are "securities and similar investments" for Regulated Funds.

offered securities exception.³ Nonetheless, we anticipate that some commenters may seek further clarity in response to the Proposal, including whether further changes to the existing framework for privately offered securities are warranted.

Comments on the Proposal are due by December 7, 2026.

This alert highlights practical implications for fund managers, then provides a brief overview of the Proposal and its changes, with a more detailed review of the Proposal in its entirety.

I. Key Takeaways for Asset Managers

For RIAs Managing Private Funds: While the Proposal would have a more limited effect on RIAs that advise only private funds and do not trade crypto assets or provide advice to separately managed account clients (“SMAs”),⁴ we still see a number of welcome changes.

The two most noteworthy components of the Proposal for these RIAs are: (1) a provision that would extend the timeframe for needing to deliver audited financial statements for a pooled investment vehicle’s first fiscal year in cases where the vehicle was formed within the last 90 days of that fiscal year (what we refer to below as the “stub period exception”), and (2) the elimination of the Public Company Accounting Oversight Board (“PCAOB”) registration requirement for accountants conducting pooled investment vehicle audits (which may be particularly beneficial for managers outside the U.S. that may have more difficulty—or may incur more expense—in finding a PCAOB-registered auditor⁵).

While we expect there may be some comments that look to refine certain aspects of the Proposal—including possible comments on (i) whether the availability of the stub period exception should turn on the timing of a pooled investment vehicle’s “formation” (vs. when the vehicle’s cash or investment activities actually commence, considering that vehicles often are formed and sit dormant for a period longer than 90 days) and (ii) whether to include additional relief from the audited financial statement requirements for funds at the end of their term with appropriate safeguards (such as, for example, investor consent or notice)—or seek further guidance on other relevant topics (including the privately offered securities exemption), we expect managers will be appreciative of the SEC’s efforts to address some of the persistent compliance headaches they face.

For RIAs with SMA Clients: RIAs with SMA arrangements stand to benefit from new exceptions that the Proposal would create with regard to discretionary trading authority, standing letters of authorization (“SLOAs”) and relief for custodial arrangements conveying inadvertent custody. In some cases, these exceptions would codify existing SEC or SEC staff guidance. The new exceptions could be particularly useful to RIAs that have non-DVP

³ “SEC Proposes Enhanced Safeguarding Rule for Registered Investment Advisers.” [Release No. IA-6240](#). See also, [“The SEC Proposes Significant Changes in a New Safeguarding Rule.”](#)

⁴ For this purpose, we mean investment advisory relationships structured as a separately managed account arrangement versus a fund-of-one (sometimes also referred to as an “SMA”).

⁵ It remains unclear, however, how many non-PCAOB-registered accounting firms have the necessary knowledge and experience to conduct audits in accordance with U.S. generally accepted auditing standards (“U.S. GAAS”), a custody rule requirement that the Proposal would leave intact. In this respect, the retention of the U.S. GAAS requirement could temper the potential impact of eliminating the PCAOB registration requirement.

(as defined below) trading arrangements, SLOA arrangements that meet only some of the conditions of SEC staff's 2017 guidance about SLOAs,⁶ or face situations creating inadvertent custody where the RIA knows (or has reason to know) that a client's custodial agreement with a custodian confers custody upon the RIA.

For Crypto-Focused Managers: The Proposal, if adopted in its current form, would provide long-awaited flexibility when it comes to custodial arrangements for crypto assets, including for less liquid or novel assets. RIAs with crypto asset strategies should take note, though, that the framework the SEC proposed for regulating crypto asset custody contains a number of elements that will likely require significant thought and investment in compliance resources. This would include meaningful time and expense devoted to relevant assessments and control reports, as well as significant documentation and processes to support those assessments.

RIAs with crypto asset strategies will likely want to begin assessing their operational readiness during the comment period. RIAs to Regulated Funds that invest in crypto assets may also want to begin socializing these potential developments with their boards, whose buy-in will be needed in connection with a number of requirements. In addition, RIAs currently using or considering the use of State trust companies as qualified custodians for crypto assets may want to consider conducting readiness and gap analyses to benchmark their current practices against the new assessments and controls that would be required.

Form ADV Implications: RIAs may also want to review the proposed changes to Form ADV to consider whether data they currently maintain regarding client holdings—including securities and amounts held for different clients with particular custody arrangements—is being tracked in a manner that would facilitate their compliance with the updated Form ADV reporting requirements, as the Proposal currently contemplates an immediate effective date for these Form ADV changes.

SEC Request for Comment: Overall, the SEC should be commended for its work to modernize the existing Custody Rules and to enable and facilitate further investment by RIAs and Regulated Funds in crypto assets, while balancing investor protection considerations. Changes in the Proposal also resolve certain interpretive questions that had been raised under prior SEC staff guidance. However, the Proposal is also quite clear that the SEC is open to using the comment process to understand what other aspects of the current framework of Custody Rules may not be working for RIAs or their investors, and given the number and significance of open questions posed by the SEC, the 60-day comment period presents an important opportunity for market participants to shape the final rules.

II. Overview of the Proposal

CUSTODY RULES MODERNIZATION

The Proposal would redesignate Rule 206(4)-2 under the Advisers Act as Rule 223-1 and make a number of welcome changes, including the following:

⁶ See, [Investment Adviser Association, No-Action Letter \(February 21, 2017\)](#).

- Key proposed changes to the Advisers Act Custody Rule:
 - Updates the audit provision for pooled investment vehicles, including by codifying exceptions for non-GAAP financial statements for foreign vehicles, formalizing extended deadlines for funds of funds and permitting an independent representative to receive pooled investment vehicle audited financial statements. Importantly, the audit provision would also permit combined audits for stub periods in certain circumstances.
 - Eliminates the requirement that accountants that perform surprise examinations, audits and internal control reports must be registered with the PCAOB.
 - Introduces a discretionary trading authority exception (proposed Rule 223-1(b)(9)), which expands the current exception / guidance relating to trading in (non-) delivery-versus-payment assets.
 - Codifies an inadvertent custody exception and the exception from the surprise examination requirement for SLOA arrangements.
 - Addresses expectations for asset segregation, use of escrow agents and the use of accommodation reporting.
 - Proposes to amend Forms ADV, ADV-E, and N-CEN to require more granular information on RIAs' custody practices and new disclosures on self-custody practices, State trust company use, and tokenized fund interests.
- Key proposed changes to the Investment Company Act Custody Rule:
 - Clarifies that BDCs are included under the Investment Company Act Custody Rule.
 - Amends Rule 17f-1 to expand the universe of eligible broker-dealer custodians to include all registered broker-dealers, subject to the condition that Regulated Fund securities and similar investments may be placed or maintained with a broker-dealer whose custody of those securities or similar investments is subject to the customer protection rule.
 - Rescinds the free cash accounts rule.

NEW SELF-CUSTODY FRAMEWORK FOR CRYPTO ASSETS

- The Proposal would permit RIAs to self-custody client crypto assets (*i.e.*, without using a qualified custodian), subject to conditions including: a written determination, made initially and quarterly, that a permitted custodian is not available to maintain the assets; a determination that the RIA has safeguarding expertise regarding each crypto asset and adopts and implements safeguarding systems meeting specified requirements, with the basis for the RIA's safeguarding expertise and systems determination documented in writing; a written review of the RIA's safeguarding systems and cybersecurity controls (also tested at least annually); internal control reports (within six months of commencing self-custody and at least annually thereafter); providing detail on self-custodied crypto assets in quarterly account statements (with exceptions for pooled investment vehicles subject to audit and Regulated Funds), among other requirements (proposed Rule 223-1(b)(7)).

- State trust companies would become a new category of qualified custodian for advisory clients (including Regulated Funds, as noted below) but only for crypto assets and related cash and cash equivalents (proposed Rules 223-1(d)(13)(v) and 17f-8). Before engaging a State trust company, the RIA would be required to have a reasonable basis, after due inquiry, for believing that the State trust company is authorized by the relevant State banking authority to provide crypto asset custody and has policies and procedures reasonably designed to safeguard crypto assets and related cash and/or cash equivalents from the risk of theft, loss, misuse and misappropriation. The RIA and Regulated Fund would also be required to receive *and review* the State trust company's audited financial statements and internal control report initially and annually thereafter. All client crypto assets would need to be segregated from the State trust company's proprietary assets, and Regulated Funds would need to have a custodial services agreement providing for that segregation.
- Regulated Funds would be permitted to maintain crypto assets with an RIA that meets the self-custody conditions described above, subject to board of directors oversight, including initial and quarterly evaluation of the RIA's permitted custodian determination and an initial and annual determination that the crypto asset will be subject to "reasonable care" if maintained with the RIA (proposed Rule 17f-9).⁷
- The Proposal would permit RIAs to maintain certain required records on a crypto network, provided the records can be produced in human-readable electronic format for Commission examination.
- The Proposal notes that the SEC is not proposing rules for DeFi activities⁸ at this time, but is soliciting extensive comment on how DeFi should interact with custody requirements. The Proposal suggests that the SEC may take other action, whether or not in the form of rulemaking, to address challenges with DeFi activities based on comment letters, and the SEC also asks about RIAs' existing approaches. The SEC also considered but declined to propose a separate crypto trading platform custody rule, thereby declining to expand the permitted custodians to trading platforms.

COMPLIANCE TIMELINE

The Proposal contemplates that various elements would be available to RIAs immediately following the effective date of the rule, but the SEC has requested comment on whether certain items may require longer lead-times or transitional periods.

⁷ Except for the self-custody exception, Regulated Funds continue to be excepted from the rest of the Advisers Act Custody Rule.

⁸ DeFi activities involve assets using smart contracts in connection with decentralized finance protocols and applications. The Proposal notes that DeFi activities may be useful for a variety of purposes integral to the functioning of crypto assets, including for transacting and earning value on crypto assets. For example, crypto assets may be deposited to smart contracts, which are self-executing software programs that can define how and when crypto assets may be purchased, sold, and transferred, as well as automate dividend, interest or other payments. Smart contracts can be used to effectuate staking arrangements that allow owners of crypto assets to earn rewards (*e.g.*, newly minted crypto assets or a percentage of transaction fees) if they commit or "stake" their crypto assets to the relevant network for a period of time.

III. Custody Rules Modernization

The Proposal includes a series of modernizing amendments to the existing Custody Rules under both the Advisers Act and the Investment Company Act.

A. ADVISERS ACT MODERNIZATION

Redesignation to Rule 223-1. The Proposal would redesignate Rule 206(4)-2 under the Advisers Act as Rule 223-1, reflecting the Commission's authority under Section 223 of the Advisers Act, as added by the Dodd-Frank Act.

Discretionary Trading Authority Exception. In a welcome change for RIAs managing SMAs, the Proposal would provide a significant new exception for RIAs currently deemed to have custody solely by virtue of their discretionary trading authority. Under current SEC guidance on "authorized trading," an RIA is not considered to have custody under the Advisers Act Custody Rule where its discretionary authority is limited to trading on a delivery versus payment ("DVP") basis (*i.e.*, where a client's custodian is generally under instruction to transfer funds (or securities) out of a client's account only upon corresponding transfer of securities (or funds)). By contrast, authority to trade "non-DVP" assets could confer custody under current SEC guidance. The new exception in the Proposal would remove the differential treatment for authorized trading for DVP vs. non-DVP assets.⁹

Under the Proposal, an RIA would not be required to comply with the Custody Rule with respect to both DVP and non-DVP assets, provided that: (a) trades are executed only (and the RIA only has authority to execute) from and into designated client accounts or where such transfer is recorded in the client's name by the issuer, (b) the RIA cannot direct (under the discretionary trading arrangement or otherwise) transfers to itself or to related persons *unless* such transfer is directed by the client in connection with such trading, and the RIA does not have the authority to have the transfer recorded by the issuer in its own name or that of a related person, and (c) the RIA complies with the Advisers Act Custody Rule for any other activities, rights, or authorities that otherwise cause it to have custody separate from such discretionary trading authority and any conditions on such authority or other exceptions.

To rely on the exception, the RIA's advisory contract with the applicable client will need to expressly authorize discretionary trading before such trading can occur; however, the Proposal also cautions that overly broad discretionary authority may constitute a more general power of attorney or arrangement authorizing the withdrawal of client funds or securities that otherwise results in the RIA being deemed to have "custody" of client funds and securities. As a result, advisory agreements will need to be reviewed carefully where an RIA seeks to rely on the exception but avoid overall custody. The RIA will also be expected to have policies and procedures that are reasonably designed to meet the conditions of the exception, with an expectation that the controls in such policies and procedures will be tested.

⁹ If the Proposal becomes a rule, the SEC would also plan to rescind the discussion in the 2003 Adopting Release on trading authority.

This exception should provide relief for RIAs that manage SMAs but may seek to avoid having custody but whose discretionary arrangements involve assets (*e.g.*, loans, CLOs and fund interests) that cannot settle on a DVP basis. (As noted, this would have more minimal impact on RIAs managing pooled investment vehicles where they are already deemed to have custody due to the RIA or its related person serving as general partner or managing member of the vehicle.) As part of the Proposal, the SEC also requests comment on whether other changes should be made, such as modifying the exemption from the qualified custodian requirements for certain privately offered securities (and does not address in any depth the guidance on certificated privately offered securities).

Elimination of PCAOB Registration Requirement. The Proposal would eliminate the current requirement that accountants performing audit and examination services under the Custody Rule be registered with and inspected by PCAOB.

This change would help to expand the pool of qualified accountants available for Custody Rule compliance, particularly for non-U.S. funds where it may be challenging to find a PCAOB auditor. The Proposal would retain the requirement that the auditor be an independent public accountant.

Audit Exception Updates, including Permitting “Stub” Audits. The Proposal would require that audited financial statements of pooled investment vehicles be prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”), while also preserving the existing exception for non-U.S. pooled investment vehicles, which permits their financial statements to be prepared in accordance with accounting principles other than U.S. GAAP, provided that the financial statements contain information substantially similar to the information contained in financial statements prepared in accordance with U.S. GAAP, including a reconciliation to U.S. GAAP for material differences, and such reconciliation is delivered to the pooled investment vehicle’s U.S. investors.

Extended delivery deadlines would be available for funds of funds, codifying existing SEC guidance, and significantly, the SEC introduces an exception permitting “stub audits.” Namely, the Proposal modifies the delivery requirements for audits for pooled investment vehicles that are formed within the 90-day period prior to the vehicle’s fiscal year end, permitting them to distribute financial statements (which may be unaudited) covering the first fiscal year within 90 days after the end of the first fiscal year, provided that audited financial statements covering both the first fiscal year partial period (the “stub” period) and the second fiscal year are distributed after the end of the second fiscal year. This is likely to provide significant relief and cost savings, while still preserving the protection of the audit, for funds formed in the last quarter, which may not have meaningful activity justifying the expense of a stub audit. The Proposal uses timing based on the “formation” of the pooled investment vehicle, which typically does not align to when the pooled investment vehicle begins its actual operations or holds a closing.

Audit reports would also be permitted to be delivered to an independent representative, similar to the permitted approach for other deliverables under the Custody Rule. As a practical matter, RIAs looking to rely on this approach would still need to review, and potentially modify, the governing agreements for their pooled investment vehicles to permit this approach.

Standing Letters of Authorization (SLOA) Exception. The Proposal would codify an exception from the surprise examination requirement for RIAs with custody arising solely from standing letters of authorization, subject to specified conditions.¹⁰

BDC Treatment. RIAs to BDCs, in addition to advisers to registered investment companies, would be explicitly excepted from the Advisers Act Custody Rule with respect to BDC assets.

Inadvertent Custody Exception. A new exception¹¹ would provide that an RIA will not be deemed to have custody under specified conditions where custody arises inadvertently from authority granted under a custodial agreement, provided: (i) the RIA did not recommend, request, or require that the client select the qualified custodian maintaining such funds and securities; and (ii) either (A) the RIA does not have a copy of the client's custodial agreement, nor actual knowledge or reason to know that any custodial agreement between the client and such qualified custodian confers custody upon the RIA; or (B) if the RIA knows or has reason to know that a custodial agreement confers custody on the RIA, the RIA promptly notifies the client and qualified custodian in writing of such unwanted authority, repudiates such authority to the client and qualified custodian, and requests in writing that such authority be removed from the custodial agreement or be superseded by a new agreement.

While the Proposal notes this exception is not creating a requirement that RIAs review all custodial agreements to which their clients are parties, it will create obligations to review – and then to remediate, including by repudiation – where the RIA does in fact receive the custodial agreement. It also creates clear conditions and expectations – in response to the specter of inadvertent custody raised by prior SEC guidance – on when an RIA will be expected to know the terms of a client's custodial arrangements to which it may not be a party. The SEC expects that RIAs should have policies and procedures in place to address circumstances where they become aware they have custody inadvertently from a custodial agreement.

Account Number Disclosure. RIAs would be required to provide the account number to clients in connection with required notices sent upon the opening of a qualified custodian account where they have custody (and do not rely on the audit exemption).

Asset Segregation and Accommodation Reporting. While the Proposal does not introduce specific new rules related to segregation of proprietary assets, use of accommodation reporting and certain other matters, the SEC does use the Proposal to preview guidance it would expect to adopt in connection with any final rule. This includes guidance that bank deposits reflected as bank liabilities where deposited into a bank account do not

¹⁰ An “SLOA” is defined as an arrangement among the RIA, the client, and the client's qualified custodian in which the RIA is authorized, in writing, to direct the qualified custodian to transfer funds and securities to a third-party recipient on a specified schedule or from time to time and is subject to certain conditions. See, [Investment Adviser Association, SEC Staff No-Action Letter \(Feb. 21, 2017\) \(“IAA SLOA No-Action Letter”\)](#). The conditions of the new exception are: (i) the client's qualified custodian cannot be the RIA or its related person; (ii) the SLOA must include the client's signature, the third-party recipient's name, and either the third-party recipient's address or account number at a custodian to which the transfer should be directed; (iii) the SLOA must provide that the RIA has no ability or authority to designate or change any information about the third-party recipient, including name, address, and account number; and (iv) the client, as the party establishing the SLOA, would have the ultimate ability to terminate or change the instruction with the qualified custodian.

¹¹ See, [IM Guidance Update “Inadvertent Custody: Advisory Contract Versus Custodial Contract Authority” \(February 2017\)](#).

violate the anti-commingling requirements and relief for commingling of certain assets held by third-party escrow agents in connection with a portfolio company sale (essentially formalizing 2014 guidance).¹²

The Proposal also includes the SEC's view that where an RIA may rely on "accommodation reporting" (where assets may be reported on a qualified custodian statement, but are not maintained), the client's account statements should disclose that the custodian does not hold or have authority to obtain such funds or securities; failure to disclose this would not permit the RIA to have a reasonable basis, after due inquiry, for believing that the account statement is generally clear and accurate, and the RIA would therefore not satisfy the account statement delivery requirements. Notably, the Proposal does not suggest that such accommodation reporting satisfies the qualified custodian requirement (unless an exception might be available for the assets using the accommodation reporting), but reflects a more moderated view than the approach under the 2023 Safeguarding Proposal, which would have required qualified custodians to "maintain" assets for which they provided reporting.

B. INVESTMENT COMPANY ACT MODERNIZATION

While likely less significant, there are a number of mechanical updates to the Investment Company Act Custody Rules, including:

BDC References. The Proposal would add BDC references throughout the Investment Company Act Custody Rules to clarify their applicability.

Broker-Dealer Custody Expansion. The Proposal would expand Rule 17f-1 to permit all registered broker-dealers subject to Rule 15c3-3 (the customer protection rule) to serve as custodians for Regulated Fund assets, removing existing enumerated conditions, including certain requirements for the Regulated Fund board to approve custodial agreements. As background, Rule 17f-1 was adopted in 1940 and it has not been substantively amended since, which has resulted in certain requirements that have ceased to prove sensible in today's modern financial systems (*e.g.*, requirements to physically segregate certificates in separate containers; the requirement for an independent accountant to examine Regulated Fund assets three times a year; restrictions on Regulated Fund assets being used as margin collateral). In the Proposal, the SEC noted that the rule's conditions now amount to "antiquated and duplicative regulatory burdens," including due to the enhanced protections afforded by the customer protection rule (Rule 15c3-3), and has noted that removing these conditions "could enhance the feasibility of broker-dealers acting as custodians for regulated fund securities and similar investments."

Rescission of Rule 17f-3. The Proposal would rescind Rule 17f-3, which governs free cash accounts, as the Commission views this rule as outdated.

Technical Corrections. The Proposal would correct an outdated address in Rule 17f-4 and update a cross-reference in Rule 17f-7.

¹² The Proposal acknowledges that the current framework under the Advisers Act Custody Rule would essentially require that client assets are segregated from those of the RIA and from the qualified custodian. The Proposal indicates that the SEC staff's view is that the Advisers Act Custody Rule would not preclude qualified custodians (including banks and broker dealers) from maintaining funds such that cash balances are held as general deposits and reflected on the custody bank's balance sheet as a liability to the client and, accordingly, are not segregated from the bank's own cash.

The Proposal also requests comment for other needed changes to the existing Investment Company Act Custody Rules, including to address certain asset types such as assets maintained at custodians that are affiliated with the Regulated Fund's RIA (and should the Investment Company Act use a similar approach to the Advisers Act in relying on internal control reports for affiliated custody arrangements), certain types of uncertificated securities (*e.g.*, Regulated Fund shares, privately offered securities, and loans, which have been addressed through a series of no-action letters addressed at assets held with transfer agents) and for certain types of cleared swap collateral contracts.

IV. Self-Custody of Crypto Assets

One of the centerpieces of the Proposal is Rule 223-1(b)(7), which would establish a framework permitting RIAs to maintain client crypto assets in self-custody without a qualified custodian, subject to a series of conditions designed to ensure adequate safeguarding. Under the Proposal, "self-custody" would be defined to mean possession by the RIA of *any* portion of a client crypto asset's key materials (*i.e.*, actual possession and not just the mere ability to obtain possession of such materials).¹³ The RIA would be permitted to engage third-party service providers to assist with self-custody functions, but the RIA would remain responsible for compliance with all applicable conditions.

Importantly, the self-custody framework would apply only when no qualified custodian is available for the crypto asset in question. The Proposal would not permit RIAs to elect self-custody as an alternative when a qualified custodian is willing and able to maintain the crypto asset. RIAs would be required to make this determination with respect to each particular asset before taking self-custody and at least quarterly thereafter.

Consistent with the scope of the Advisers Act Custody Rule and jurisdictional framework, the Custody Rule, and therefore the self-custody exception, would apply only to crypto assets that constitute "funds or securities," including tokenized securities and crypto assets that are digital representations of funds (*e.g.*, cash, bank accounts, payment stablecoins issued by stablecoin issuers, tokenized deposits). The SEC made clear that digital commodities, which include, for example, Bitcoin, Ether, and Solana, would be outside the scope of the Advisers Act Custody Rule.

The Proposal notes that the SEC would expect RIAs to have policies and procedures addressing each element of the rule to satisfy their compliance obligations under Advisers Act Rule 206(4)-7, the compliance rule.

A. QUALIFIED CUSTODIAN DETERMINATION

As a threshold requirement, an RIA seeking to rely on a self-custody approach would need to have a reasonable basis, after due inquiry, for determining, on an initial basis and at least quarterly thereafter, that no qualified custodian will maintain the particular crypto asset (the "QC determination"). The QC determination would need to be made in writing and individualized to each crypto asset, and blanket determinations across an RIA's entire crypto portfolio would not be permitted. If the RIA later determines that a qualified custodian has become

¹³"Key materials" would mean the cryptographic private keys or any part thereof that is necessary to access and effectuate transactions in the corresponding crypto asset.

available to maintain the client's crypto asset, it would be required to place such crypto asset with the qualified custodian as soon as reasonably practicable.

The Proposal anticipates that the RIA's reasonable basis for its QC determination would be formed through due inquiry into material facts concerning, among other things, each individual crypto asset and its characteristics; the custodial marketplace for the crypto asset; and whether custodians generally known in that marketplace provide custodial services for the crypto asset in question. Notably, the Proposal would not permit an RIA to base its QC determination on the costs of engaging a qualified custodian; rather the determination would need to reflect that no qualified custodian will maintain the specific crypto asset.

B. SAFEGUARDING EXPERTISE AND SYSTEMS

The RIA would need to have expertise regarding the safeguarding of each crypto asset held in self-custody (and would need to document the basis of its determination that it has such expertise), and the Proposal cautions that not all RIAs may have such expertise. The Proposal uses a principles-based, non-prescriptive approach, recognizing that different crypto assets may require different expertise and technical capabilities. As with the QC determination, this assessment of expertise would need to be made for each crypto asset and the RIA would need to make this assessment on an "ongoing" basis.

At a minimum, the RIA's safeguarding systems would need to address three critical requirements:

- **Private Key Management:** The RIA would need to maintain systems and procedures to manage and protect key materials against loss and unauthorized access, although the Proposal does not mandate a specific storage method. Access to key materials would need to be limited to supervised persons designated by the RIA (and, for crypto assets held for a Regulated Fund, designated by resolution of the Regulated Fund's board) and, importantly, the self-custody exception would not permit sharing key materials with the client.
- **Unauthorized Transfers / Joint Authorization:** RIAs' safeguarding systems would need to be designed to prevent unauthorized transfers of crypto assets, including by requiring joint authorization of transfers by two or more designated persons, at least one of whom must be a management person of the RIA (and, for crypto assets held for a Regulated Fund, that management person must also be an officer of the Regulated Fund). The Proposal does not prescribe specific technology, but measures such as multiple key shares, multi-signature wallets and other forms of verification may be used.
- **Segregation:** Each client's crypto assets would need to be segregated by separate crypto asset addresses, ensuring that client assets are not commingled with the RIA's proprietary holdings or with the holdings of other clients. Omnibus wallets would not be permitted.

The RIA would be permitted to rely on self-custody only for crypto assets for which *it* provides advice and therefore would not be permitted to self-custody crypto assets through affiliates.

C. CYBERSECURITY CONTROLS

The proposed self-custody exemption provides certain general core elements that RIAs would need to address when implementing their cybersecurity measures. First, the RIA would need to assess, in writing, and implement measures to mitigate cybersecurity risks associated with self-custody, with assessments made periodically but no less than annually and before taking self-custody of crypto assets in the case of the initial assessment. Second, the RIA would need to take measures reasonably designed to detect, mitigate and remediate any cybersecurity threats and vulnerabilities with respect to the RIA's safeguarding systems. Finally, the RIA would need to take measures reasonably designed to detect, respond to and recover from a cybersecurity incident relating to the RIA's safeguarding systems.

D. INTERNAL CONTROL REPORTS¹⁴

The RIA would need to obtain a written internal control report¹⁵ from an independent public accountant within six months of first taking self-custody and no less frequently than once each calendar year thereafter. The report would need to include an opinion of whether controls were suitably designed and implemented and operating effectively throughout the period to achieve control objectives relating to custodial services, including the safeguarding of crypto assets held by the RIA on behalf of its advisory clients, and the accountant would need to verify that the crypto assets are reconciled to the crypto network. These reports would be intended to provide an independent assessment of the adequacy of the RIA's safeguarding systems and controls.

E. ACCOUNT STATEMENTS

Quarterly account statements would need to be provided to clients and must identify, for each crypto asset held in self-custody: the applicable crypto asset addresses, the amounts held, all transactions during the period, and a prompt urging the client to compare the statement with on-chain records. Account statements could be delivered in electronic format. If the RIA or a related person is a general partner of a limited partnership or holds a comparable position with another type of pooled investment vehicle that holds the self-custodied crypto assets, the account statement under the rule must be provided to the limited partners or other beneficial owners in the pooled investment vehicle, **except** where the pooled investment vehicle undergoes a financial statement audit at least annually and upon liquidation in accordance with the audit provision of the Custody Rule. Account statements would also not be required with respect to Regulated Funds (which are separately subject to audit).

F. FINANCIAL ASSET ELECTION UNDER STATE LAW

The RIA and each client would need to agree in writing to treat each crypto asset held in self-custody as a "financial asset" and the RIA as a "securities intermediary" under applicable state law governing the advisory

¹⁴ The Proposal's preview of revisions to guidance for accountants notes that for RIAs that receive internal control reports for multiple reasons under the Advisers Act (*i.e.*, to satisfy the self-custody requirement and also with regard to custody by related persons of non-crypto assets), it may not be appropriate for this to be combined in one report and two control reports may be needed, including where different parties are responsible for the relevant controls.

¹⁵ A SOC 1 Type 2 report would satisfy this requirement, but a SOC 1 Type 1 report would not because the latter does not test operating effectiveness of the controls.

contract. This election would be designed to provide clients with the protections afforded to holders of financial assets under the applicable state's enacted version of Article 8 of the Uniform Commercial Code, including priority in the event of the RIA's insolvency. RIAs will be required to retain a copy of such elections.

G. USE OF SERVICE PROVIDERS

RIAs would be permitted to use third-party service providers under the self-custody exception, subject to the RIA's oversight. This could include having a third party assist with cybersecurity requirements. However, the Proposal specifies that, where an RIA uses a third party's crypto wallet technology and/or software platform to manage key materials rather than building its own technology in-house, the service provider should not have access to the crypto asset's key materials or otherwise have the ability to unilaterally move a client's crypto asset. The Proposal expects that RIAs would need to determine, as part of their due diligence on these wallet providers and before engaging them, whether such providers' capabilities give them access to key materials and/or other means to unilaterally move a client's crypto asset.

H. AIRDROP PROVISION

The Proposal includes a practical accommodation for the receipt of airdropped or otherwise distributed crypto assets. Receipt of such assets by the RIA would not be deemed a custody violation, provided the RIA, as soon as reasonably practicable after becoming aware of the airdrop, either comes into compliance with all of the self-custody conditions or places and maintains the distributed crypto asset at a permitted custodian. The Proposal does not provide specific timeframes for what constitutes "as soon as reasonably practicable," which will be based on the relevant facts and circumstances.

V. Regulated Fund Self-Custody

Proposed Rule 17f-9 under the Investment Company Act would permit a Regulated Fund¹⁶ to maintain crypto assets with its RIA in self-custody, subject to two principal requirements:

1. **RIA Compliance:** The RIA would need to comply with all conditions of the self-custody rule (proposed Rule 223-1(b)(7)), as described above.
2. **Board Oversight:** The Regulated Fund's board of directors (a majority of whom must be independent) would need to exercise active oversight of the self-custody arrangement.

Specifically, the board would need to:

- Evaluate the RIA's QC determination prior to the RIA initially self-custodying the crypto asset, and on at least a quarterly basis thereafter. This includes a review of the RIA's written report documenting its determination for believing that no qualified custodian will maintain the crypto asset.

¹⁶ Only Regulated Funds can rely on the self-custody of the RIA; UITs and FACCs are not permitted to rely on the exemption under the Proposal.

- Determine, both initially and on at least an annual basis, that the crypto asset will be subject to reasonable care if maintained with the RIA. To facilitate the board's determination, the proposed rule would require the RIA to furnish, and the Regulated Fund's board to evaluate, such information as may reasonably be necessary for the board to evaluate the fund's custody arrangement of the crypto asset.

The board oversight requirement reflects the SEC's view that the fiduciary duty of the Regulated Fund's board provides an additional layer of investor protection beyond the conditions imposed directly on the RIA, consistent with Rule 17f-2, which requires a Regulated Fund's board to approve the personnel that have access to self-custodied fund assets and the fund personnel that receive the related transaction records.

VI. State Trust Companies as Permitted Custodians

State trust companies would be permitted to act as custodians for crypto assets and related cash and cash equivalents for RIAs and for Regulated Funds under proposed Rules 223-1(d)(13)(v) and 17f-8. The Proposal builds on the no-action relief previously issued by the SEC staff to Simpson Thacher & Bartlett LLP.¹⁷

Under the Proposal, a State trust company would be defined as "a legal entity organized under State law that is supervised and examined by a State authority having supervision over banks and permitted to exercise fiduciary powers under applicable State law." Per the Proposal, approximately 19 State trust companies currently specialize in crypto custody services and could potentially qualify under this new framework.

The Proposal pre-supposes that at least some State trust companies do not currently meet the definition of qualified custodian and in that regard notes that the proposed requirements would only apply to State trust companies that are not otherwise already qualified custodians.

The conditions for utilizing a State trust company to custody crypto assets are as follows:

1. **State Authorization Determination:** The RIA (or Regulated Fund, as applicable) would need to determine in writing, initially and annually, that it has a reasonable basis for believing, after due inquiry, that the State trust company is authorized by the relevant State law to custody crypto assets and related cash and/or cash equivalents. This could be based on an opinion of counsel or certification by the State trust company, in conjunction with other diligence.
2. **Policies and Procedures Determination:** The RIA would need to determine in writing, initially and annually, that it has a reasonable basis, after due inquiry, for believing that the State trust company maintains and implements written policies and procedures reasonably designed to safeguard crypto assets and related cash and/or cash equivalents from the risk of theft, loss, misuse and misappropriation. Those policies and procedures must address, at a minimum, private key management and cybersecurity. An RIA or Regulated Fund would want to consider obtaining a certification from the State trust company or an assessment by counsel or another third party

¹⁷ See, ["Simpson Thacher & Bartlett LLP, SEC Staff No-Act. Letter" \(pub. avail. Sept. 30, 2025\)](#).

- regarding the adequacy and implementation of the State trust company's policies and procedures to support its reasonable-basis determination.
3. **Audited Financial Statements:** The State trust company would need to provide its most recent annual financial statements, which would need to be received and reviewed by the RIA or Regulated Fund prior to engaging the State trust company and annually thereafter, and the RIA or Regulated Fund would need to confirm that the financial statements were prepared in accordance with U.S. GAAP and audited by an independent public accountant.
 4. **Internal Control Report:** The State trust company would need to provide an internal control report prepared by an independent public accountant addressing the adequacy of its safeguarding systems and controls which would need to be received and reviewed by the RIA or Regulated Fund prior to engaging the State trust company and annually thereafter.
 5. **Segregation of Client Assets / Custodial Services Agreement:** The State trust company would need to segregate client assets from its proprietary assets. For Regulated Funds, the Proposal would require a custodial services agreement that provides that all crypto assets and related cash and/or cash equivalents would be held in accounts segregated from the State trust company's proprietary assets (this is not explicitly required for other types of clients under the Proposal).¹⁸ Unlike the self-custody exemption, State trust companies would be able to custody client crypto assets in omnibus addresses so long as such accounts are segregated from proprietary assets of the trust company.

RIAs would be required to document and retain records of these determinations and reviews.

Form ADV would also be amended to require an RIA to disclose whether a State trust company maintains client funds or securities pursuant to the Proposal.

The Proposal requests comment on whether other non-traditional or alternative asset classes may face the same difficulties posed by crypto assets in identifying traditional qualified custodians where the Custody Rules otherwise do not permit an exception to the qualified custodian requirements.

VII. Disclosure and Reporting Amendments

The Proposal includes amendments to several key reporting forms to capture information about crypto custody practices and related matters:

- **Form ADV Amendments:** New questions would be added to Form ADV Part 1 for both private funds (in Section 7.B. of Schedule D) and other types of advisory clients (including Regulated Funds in respect of certain Item 9 questions and SMA clients in Item 5 and corresponding Schedule D questions) regarding self-custody practices, the use of State trust companies as custodians, and whether the RIA manages

¹⁸ As with the self-custody exemption described above, UITs and FACCs are not permitted to use non-bank State trust companies under the Proposal.

tokenized private funds (including reporting of individual series or classes that are tokenized). Conforming amendments would update Form ADV to reflect the redesignation of the Advisers Act Custody Rule.

- The Proposal also introduces certain other clarifications, such as clarifying instructions under Item 9 where an RIA is deemed to have custody but is permitted to rely on certain exceptions to elements of the Custody Rule. It also will add new questions regarding an RIA's reliance on the privately offered securities exception, exception from certain custody requirements where the RIA has the ability to deduct fees; custody arising from operational independence; reliance on the SLOA exception; reliance on the discretionary trading authority exception and reliance on having repudiated inadvertent custody. This information would provide SEC examination teams with significantly more detailed information on an RIA's use of current and proposed exemptions and enable them to more easily test for compliance with the conditions thereof. Item 9 reporting will also now include more granular breakdowns by client and type of custody of amounts of funds and securities for which the RIA and its related persons have custody that could necessitate new tracking of such amounts by client arrangement, particularly for RIAs relying on various exceptions to the Custody Rules for SMA clients.
- **Form N-CEN Amendments:** Form N-CEN would be amended to require reporting on whether a Regulated Fund utilizes self-custody or a State trust company custodian, and whether the fund issues tokenized fund shares (including particular series or classes).
- **Form ADV-E Amendments:** Conforming amendments to Form ADV-E would reflect changes to the Advisers Act Custody Rule.

In addition, the Proposal would require RIAs (in their Form ADV Part 2A or otherwise) and Regulated Funds to provide risk disclosure to clients and investors regarding the risks associated with self-custody of crypto assets, including custodial / misappropriation (in the case of self-custody) risks, risks related to use of State trust companies, limited recourse risks (and any mitigants), cyber risks and other potential risk elements. The Proposal includes a detailed discussion of the types of risks that may need to be addressed, including discussion of the manner in which a client's crypto assets will be held or whether and how the RIA engages in DeFi activity.

VIII. Recordkeeping Requirements

The Proposal would impose new recordkeeping obligations under both the Advisers Act and Investment Company Act for RIAs or Regulated Funds that self-custody crypto assets or use State trust companies as custodians for crypto assets. The required records would include:

- Self-custody: QC determinations; documentation of RIA's safeguarding expertise; records of designated key holders; safeguarding systems review documentation; RIA cybersecurity assessment; internal control reports from independent public accountants; annual review; client account statements and records of providing to clients; financial asset election documentation; information reasonably necessary to reconstruct all financial positions and transactions related to the client crypto assets, including, at a minimum, client names, client account numbers, crypto asset addresses, transaction amounts, transaction

destinations, transaction authorizations, and relevant metadata; and such other records as may be required. For Regulated Funds, records related to board oversight of the RIA and assessments as discussed above will also be required.

- State trust companies: trust company determinations (of elements described above) and audited financials and internal control reports for such companies.
- Records of clients with SLOAs (with holding periods tied to while the SLOA continues to be in effect) and reliance on exception from the surprise examination requirement.

Notably, the Proposal would permit RIAs to maintain required crypto asset-related records on a crypto network (*i.e.*, a blockchain), provided that the records can be provided to the Commission in human-readable electronic format upon request. This accommodation reflects the Commission's recognition that certain records relating to crypto assets may be most naturally maintained in on-chain form.

If the Proposal is adopted, RIAs will want to consider updates to their policies and procedures, including any record retention schedules, as well as ancillary matters, such as Form ADV Item 1 updates that may be required if records will be maintained with third parties (*e.g.*, on the blockchain).

IX. Compliance Date

The Proposal contemplates immediate compliance dates for its various elements, and RIAs and Regulated Funds would be able to rely on the self-custody and State trust company rules as of the effective date of the final rule as soon as the RIA or Regulated Fund is able to comply with all applicable conditions and recordkeeping requirements. RIAs and Regulated Funds would be able to rely on the proposed rules pending availability of the updated Forms ADV, ADV-E and N-CEN, and would file using updated forms when they are available. RIAs and Regulated Funds would need to continue to comply with all applicable rules and instructions regarding risk disclosure, including with regard to self-custody of crypto assets.

The Proposal specifically asks whether there are elements that should not take effect immediately, including in cases where an RIA may currently have inadvertent custody of crypto assets and will need to take steps to come into compliance. The Proposal also notes that an immediate effective date for Form ADV changes, including changes to certain questions in Item 9, could necessitate a prompt other-than-annual amendment to respond to the new questions.

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