

Legal Update

U.S. Representatives Urge SEC to Take Action on Custody of Digital Securities

On December 9, 2020, a bipartisan group of members of the U.S. House of Representatives, including Tom Emmer (R-MN-6), Warren Davidson (R-OH-8), Bill Foster (D-IL-11), David Schweikert (R-AZ-6), Darren Soto (D-FL-9), Ted Budd (R-NC-13), Dan Crenshaw (R-TX-2), Ralph Norman (R-SC-5) and Ro Khanna (D-CA-17),¹ penned a letter² addressed to U.S. Securities and Exchange Commission (“SEC”) Chairman Jay Clayton urging the SEC and Financial Industry Regulatory Authority (“FINRA”) to address the issue of broker-dealer custody of digital securities.³

Although SEC Commissioner Hester Peirce has long championed the need for both regulatory and technological innovation in the crypto space, the SEC and FINRA have made slow progress towards finding a solution that would permit broker-dealer custody of digital securities. The last major pronouncement on this issue was a 2019 Joint Statement by the SEC Division of Trading and Markets and FINRA’s Office of General Counsel that highlighted some important considerations regarding the custody of digital securities but provided few answers to industry participants.⁴

Recent Developments in Digital Asset Custody

In the absence of action by the SEC and FINRA, other regulators have recently stepped up to the plate to permit custody solutions for digital assets. An interpretive letter issued in July 2020 by the Office of the Comptroller of the Currency (“OCC”) recognized the authority of national banks and federal savings associations to provide digital asset custody services on behalf of customers.⁵

State regulators have also tried to make strides in regulatory innovation in the crypto space: the Wyoming Division of Banking, a leading state regulator in digital asset innovation, issued a no-action letter opining that a Wyoming-chartered public trust company is a “qualified custodian” under the Investment Advisers Act of 1940, following the OCC’s interpretive guidance.⁶ However, in response, the SEC Division of Investment Management staff issued a statement gently reminding market participants that the SEC has final say in matters of federal interpretation.⁷

The Letter

The authors of the letter recognized recent developments in digital asset custody from the OCC and were critical of the SEC and FINRA's lack of action to date, terming the current situation "unsustainable." Specifically, the letter took exception to the treatment of broker-dealer applications for firms that would provide custody services for digital securities, noting that "FINRA has not outright denied any broker-dealer applications that involve the custody of digital securities, which would render the applications eligible for appeal. Rather, FINRA has allowed the applications to languish—often for years—or asked the applicants to withdraw such applications."

The letter proposes that the SEC take three actions to resolve the current gridlock:

1. Explicitly confirm that banks may act as good control locations for the custody of digital securities.
2. Advise FINRA on the requirements for broker-dealers to be able to custody digital securities for their customers as well as for their own account.
3. Instruct FINRA to approve broker-dealer applications that meet the requirements necessary to custody digital securities.

This Commission has prided itself in its approach to technological innovation in the securities markets, demonstrating its commitment by, among other things, establishing its Strategic Hub for Innovation and Financial Technology, commonly referred to as FinHub, as a stand-alone office.⁸ Although the SEC's commitment, as a whole, to innovation in the realm of digital assets has been somewhat more tenuous, this letter could prompt action on an issue that has long left both retail and institutional investors without an SEC-regulated custody solution.

Given that Chairman Clayton has publicly announced that he intends to step down from his position at the end of 2020, the likelihood that the current administration will pick up this issue is remote. However, attitudes towards digital assets under a Biden administration remain to be seen.

For more information about topics raised in this Legal Update, please contact any of the lawyers listed below.

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[ba7d-948e17d5997c/80FB016200931AB58DE445BF1405D219.custody-congressional-letter-final.pdf](https://www.sec.gov/foia/ba7d-948e17d5997c/80FB016200931AB58DE445BF1405D219.custody-congressional-letter-final.pdf)

³ In the letter, "digital securities" refers to "both securities issued on a blockchain or distributed ledger... and distributed ledger-based representations of traditional securities."

⁴ SEC Division of Trading and Markets & FINRA Office of General Counsel, *Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities* (July 8, 2019), <https://www.sec.gov/news/public-statement/joint-staff-statement-broker-dealer-custody-digital-asset-securities>.

⁵ OCC, *Re: Authority of a National Bank to Provide Cryptocurrency Custody Services for Customers*, Interpretive Letter #1170 (July 22, 2020), <https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1170.pdf>.

⁶ Wyoming Division of Banking, *No-Action Letter on Custody of Digital Assets and Qualified Custodian Status* (Oct. 23, 2020), <http://wyomingbankingdivision.wyo.gov/home/pressreleases/twooceanno-actionletterdigitalassetcustodyqualifiedcustodianstatus>.

⁷ SEC Division of Investment Management, *Staff Statement on WY Division of Banking's "NAL on Custody of Digital Assets and Qualified Custodian Status"* (Nov. 9, 2020), <https://www.sec.gov/news/public-statement/statement-im-finhub-wyoming-nal-custody-digital-assets>.

⁸ SEC, *SEC Announces Office Focused on Innovation and Financial Technology* (Dec. 3, 2020), <https://www.sec.gov/news/press-release/2020-303>.

Endnotes

¹ Rep. Crenshaw is the only signatory that is not a member of the Congressional Blockchain Caucus, a bipartisan group of members of Congress and staff that advocates for blockchain technology solutions.

² Letter to SEC Chairman Jay Clayton from Rep. Tom Emmer et al. (Dec. 9, 2020), https://emmer.house.gov/_cache/files/1/b/1b5ad16a-dcb1-4849-



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