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'Preposterous' SEC Rule For Real Estate Could Be Dropped

By **Charlie Innis**

Law360 (May 7, 2025, 8:19 PM EDT) -- A proposed rule to make the U.S. Securities and Exchange Commission's custodial requirements for investment advisers apply to all assets, including real estate, could die under current Republican leadership. Some attorneys say the proposal lacked sense to begin with.

Commissioner Mark Uyeda said in a conference speech earlier this year that a 2023 proposal to broaden the scope of an SEC rule requiring advisory client assets to be held by a qualified custodian, such as a bank or a broker-dealer, will be revisited and possibly withdrawn.

The proposed rule, referred to as the safeguarding rule, has a catch-all approach that is ill-suited for real estate, attorneys told Law360 Real Estate Authority.

"When I talked to colleagues of mine who are real estate lawyers, and I was showing them some of the language of the proposal, we all agreed, 'Well, this is preposterous. This doesn't make any sense,'" said Adam Kanter, a partner at Mayer Brown LLP who counsels investment advisers on fund formation and regulatory matters.

The proposed rule faced opposition across the board, said Gregory Larkin, a partner in Goodwin Procter LLP's private investment funds practice.

"Other regulators, other countries, the investors, the advisers, everybody hated it. Everyone was like, 'Who is the constituency for this rule? Why are we doing this?'" Larkin said. "I think it was a complete overreach on rethinking a rule that does need some work, but without really considering what the correct role of the SEC is."

Custody and Safeguarding

The SEC announced the proposed safeguarding rule in 2023, when the federal agency was generally mulling ways to regulate the cryptocurrency industry after the collapse of FTX.

The proposal sought to broaden the applications of the investment adviser custody rule, a regulation that was last amended by the SEC in 2010 in the aftermath of the Bernie Madoff scandal.

The existing custody rule requires investment advisers who have access to a client's cash and securities to maintain them with a qualified custodian, such as a bank, broker-dealer or futures commission merchant.

One of the goals of the rule is to ensure that the cash and securities are kept in a separate account and not mixed up with the investment adviser's assets, Larkin said.

The 2010 rule also calls for advisers to undergo an annual "surprise examination" by an independent accountant to verify the state of the assets.

In late 2020, the SEC asked the public for comments on what custody requirements should look like for cryptocurrencies.

Larkin noted that one of the issues the agency was debating at the time is that a lot of digital assets can't be maintained in a way that complies with the custody rule.

"The safeguarding rule that came out was just a complete rethinking of the whole custody rule concept," Larkin said. "It was not what anyone that I'm aware of was expecting."

The proposed rule called for custodial requirements to apply to all assets, including cryptocurrencies and physical assets, such as artwork, precious metals and real estate.

Kanter said the SEC may have been attempting to "future-proof" the rule by broadening it.

"It was a philosophical point of, 'We're not going to chase the next hot thing, let's make it asset class-agnostic. Let's cover the waterfront,'" he said.

Real Estate Issues

The SEC's written proposal for the rule acknowledges that certain types of physical assets can't be maintained by a qualified custodian. Some custodians may even refuse custody "because the inherent physical characteristics of the items increase the expenses associated with their maintenance and safekeeping."

Some assets, also, "by their very nature or size may not easily be subject to theft or loss," which thus reduces the need for safeguarding protections, the proposal says.

Additionally, the proposal states that "physical evidence of physical assets" do not fall under the rule's exception.

In the context of real estate, a "deed or similar indicia of ownership that could be used to transfer beneficial ownership of a property would not qualify for the exception, but the physical buildings or land would qualify."

Kanter found the language concerning deeds particularly perplexing.

"There's no magic to a deed. It's just a piece of paper that conveys the property," Kanter said. "That was a very odd thing, in the real estate world, to look at how that proposal would have affected real estate managers."

Larkin said the way the proposed framework applied to real estate raised a lot of logistical questions.

"There are a patchwork of local regulations as to where you keep real estate deeds or other things like that," Larkin said. "Are we now going to have to violate those laws to keep them with somebody else?"

Transferring a deed to a custodian doesn't have any impact on how local laws establish who owns the title to a property, Kanter said.

"It doesn't prevent anyone from creating a new deed and trying to transact in it," Kanter said. "It's pure surplusage and doesn't really speak to how transactions in real estate actually take place."

What's Next

In May 2024, then-SEC Chair Gary Gensler said at an asset management industry conference that the commission received "robust feedback" on the proposed safeguarding rule.

According to the transcription of his remarks, he said he had asked staff to consider the possibility of seeking further comment on a modified version of the proposal.

In March of this year, SEC Commissioner Uyeda said at an investment management conference that commenters on the proposal "expressed significant concern" with its broad scope and how it extended custodial requirements to "virtually any asset, including crypto."

"As such, I have asked the SEC staff to work closely with the crypto task force to consider appropriate alternatives, including its withdrawal," Uyeda said at the time.

A representative for the SEC declined to comment Wednesday on what the current commission's goals are for the proposed rule.

Whatever the SEC's next move is on custody regulations, the commission's actions will probably be industry-friendly, Larkin said.

Some commissioners have publicly stated they expect to take some action on custody regulations for cryptocurrencies, though it's unclear whether that action will take the form of reproposed rulemaking or something else, he noted.

Commissioner Hester Peirce has heavily implied in public remarks that they will consider rules for cryptocurrencies separately from other assets.

"I would be shocked if the stuff on real estate makes it because there was so much pushback on it," Larkin said. "And it's just wildly impractical to do it."

--Editing by Haylee Pearl and Lakshna Mehta.