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VIA ELECTRONIC FILING May 8, 2023

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549-1090

Re: *Safeguarding Advisory Client Assets*, Release. No. IA-6240; File No. S7-04-23

Dear Ms. Countryman:

On behalf of Galaxy Digital Holdings LP and its affiliates (collectively, "Galaxy"), we respectfully submit this letter in response to the request by the Securities and Exchange Commission ("SEC") for comment in connection with a proposed new rule under the 1940 Investment Advisers Act, as amended (the "Investment Advisers Act" or the "Act"), *Safeguarding Advisory Client Assets*, No. S7-04-23 ("Proposal"), in which the SEC proposes to amend the current advisor custody rule set forth in Rule 206(4)-2 of the Act.

Galaxy agrees with the SEC on the importance of ensuring that investment advisors properly safeguard client assets. But the current Proposal is not the best way to achieve this objective. If adopted in its current form, the Proposal would (1) dramatically expand the custody rule to regulate a broad array of client assets—including cryptocurrency assets—held by investment advisors that Congress has not given the SEC authority to regulate, (2) create practical challenges as to which qualified custodians providing safeguarding services are permitted to be used to meet advisors' obligations under the custody rule, and (3) introduce a host of costly and burdensome changes to the contractual and business relationships between advisors and qualified custodians.

As currently framed, the Proposal could severely harm traditional SEC-registered investment advisors ("RIAs"), their clients, and those providing custody or safeguarding services to RIAs. Moreover, the Proposal's application of onerous custody restrictions to client cryptocurrency assets could also materially curtail the developing digital asset economy in the

United States. In light of these issues, the SEC should at a minimum extend the comment period currently allotted for public input on the Proposal to give interested stakeholders an adequate opportunity to assess and provide feedback on the Proposal. In any event, the SEC should not adopt the Proposal in its current form.

Galaxy is a trusted financial services firm, with a compliance-first mindset, focused on providing institutions and other qualified clients with access to the cryptocurrency economy. Galaxy offers a full suite of financial services for a digitally native ecosystem through its core businesses in trading, asset management, investment banking, mining and principal investments in cryptocurrencies and other digital assets. For example, Galaxy's asset management business, Galaxy Asset Management ("GAM"), manages over $2 billion in traditional and digital asset investments on behalf of clients. GAM primarily uses qualified third-party custodians to maintain and safeguard fund client assets on a one-to-one basis in cold storage with insurance protection. GAM operates mainly through Galaxy Digital Capital Management LP, an SEC-registered investment adviser.

In light of the far-reaching nature of the Proposal, Galaxy respectfully joins in the recent requests filed with the SEC by the Securities Industry Financial Markets Association ("SIFMA") and other asset manager trade associations seeking a 60-day extension of the comment period for the Proposal. The Proposal consists of 432 pages of dense materials, which include sweeping changes to existing regulatory definitions and rules applicable to RIAs and hundreds of discrete requests for public comment on a variety of granular subjects pertaining to how the Proposal could impact the asset management industry. It is, as noted by SIFMA and other commentators, "broad based, complex, and technical" and would make "changes that will drastically and permanently alter" existing custody businesses in the United States.[1] For example, the Proposal contains a flurry of regulatory changes aimed at RIAs that would remake the business relationships between or among RIAs, qualified custodians, and RIA clients and would impose an array of financial costs and other burdens on such market participants that cannot be properly quantified or assessed within the existing comment period. Given the importance of the topic, the number and breadth of the changes proposed, and the pace and complexity of the SEC's parallel rulemaking in recent months, additional time is needed for interested stakeholders to perform the level of analysis that the Proposal merits and provide meaningful feedback.

Nevertheless, based on Galaxy's review of the Proposal during the limited time currently allotted, it is clear that the Proposal should not be adopted in its current form for at least the following reasons:

First, the Proposal seeks to adopt several rule changes that exceed the SEC's statutory authority. The Proposal would, for example, enlarge the current custody rule—which currently

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[1] *See* Comment Letter to the SEC concerning the Proposal from SIFMA and other trade associations (Mar. 3, 2023), *available at* https://www.sec.gov/comments/s7-04-23/s70423-20164520-334415.pdf.

covers client "securities" and related "client assets" (such as cash proceeds from the disposition of client securities)—to cover any and all client assets, including commodities derivatives such as gold, silver, and Bitcoin futures over which an RIA has custody. The SEC does not have statutory authority to effect such an expansion. The Investment Advisers Act makes clear that it applies to *securities* investment advisors by defining "investment advisor" as anyone in the business of advising clients as "to the value of *securities* or as to the advisability of investing in, purchasing, or selling *securities*[.]"[2] Against that backdrop, the Act's provision authorizing the SEC to promulgate rules as to steps that investment advisors must take "to safeguard client assets over which such advisor has custody"[3] is plainly limited to the types of "client assets" managed by *securities* investment advisors. In restricting the Act's reach to securities investment advisors, Congress necessarily curbed the SEC's rulemaking authority to the formulation of safeguarding rules for securities and associated client assets typically managed by such securities market participants. Nothing in the statute permits the SEC to promulgate safeguarding rules for companies advising clients on investments in baseball cards, antiques, diamonds or other assets with no direct nexus to securities transactions. Congress does not "typically use oblique or elliptical language to empower an agency to make a radical or fundamental change to a statutory scheme."[4] Under the separation of powers principles enshrined in our nation's Constitution, the SEC and other executive branch "agencies have only those powers given to them by Congress."[5] Where, as here, there is not "clear congressional authorization" to regulate in the manner proposed by a government agency, the agency's proposal is without force or effect.[6]

Second, the Proposal puts the cart before the horse by effectively requiring that RIAs safeguard customer cryptocurrency assets at a narrow universe of "qualified custodians"—namely, banks, savings associations, or foreign financial institutions ("FFIs") that the SEC does not even have supervisory jurisdiction over—before there are workable rules or even a market for these institutions to do so. With respect to broker-dealers, the category of qualified custodians that the SEC does supervise, the SEC has yet to develop a workable model to permit safeguarding cryptocurrency assets. The only avenue the SEC provides for broker-dealers is under December 2020 guidance that sunsets in 2025.[7] Under this guidance, a broker-dealer's business would need to be limited exclusively to digital asset securities (and, thus, not even digital asset commodities

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[2] 15 U.S.C. § 80b-2(a)(11) (emphasis added).
[3] *Id.* § 80b-18b.
[4] *West Virginia* v. *E.P.A.*, 142 S. Ct. 2587, 2609, 2614-15 (2022) (invalidating government agency's proposed environmental regulations because they would have enacted a novel and sweeping regulatory scheme absent "clear congressional authorization").
[5] *Id.*
[6] *Id.* at 2614-15.
[7] *Custody of Digital Asset Securities by Special Purpose Broker-Dealers*, SEC Release No. 34-90788 (Dec. 23, 2020).

like Bitcoin), which is impractical as a business model and something the SEC has yet to approve for a single firm.[8]

While the Proposal purports to allow the use of banks and similar types of institutions as qualified custodians, there are only a handful of banks and other qualified custodians that provide safeguarding services for cryptocurrency assets in the United States. Recent regulatory developments in the United States have chilled, rather than encouraged, such institutions to offer custody services for cryptocurrency. In 2022, for example, the SEC issued Staff Accounting Bulletin 121 ("SAB 121"), which required covered companies to record a liability on their balance sheets at fair value for all cryptocurrency assets held on behalf of clients. To comply with this requirement, any custodians covered by the bulletin were obligated to record additional theoretical assets equal to the amount of cryptocurrency they held for clients, thereby inflating their balance sheets. As a result, SAB 121 discouraged banks from participating in qualified-custodian activity at all. More recently, the Board of Governors of the Federal Reserve Bank System and other bank regulators issued a joint statement in January raising "safety and soundness concerns" with respect to cryptocurrency-related activities by banks. This was followed by a wave of financial institutions closing the bank accounts of (or otherwise debanking) firms engaged in cryptocurrency-related activities. The cumulative effect of these developments is that even if an RIA is still permitted to custody cryptocurrency assets at a bank under the Proposal, it is not certain that a sufficient number of banks will be interested in providing such services.

Meanwhile, the Proposal contemplates shrinking the pool of qualified custodians even further by narrowing the definition of FFIs. Under the current custody rule, FFIs include any foreign financial institution that customarily holds financial assets for its customers, provided that clients' assets are segregated in customer accounts. The new definition of FFIs would only include entities that meet a series of specific conditions and requirements (e.g., being regulated by a foreign government agency and being required to comply with certain anti-money laundering requirements). This change would put U.S. asset managers at a disadvantage to their foreign counterparts, who will still have access to the full range of foreign financial institutions. In addition, the Proposal's requirement that FFIs consent to enforcement of judgments directly by the SEC for civil monetary penalties is another example of the SEC exceeding its statutory authority. The SEC has no authority to regulate FFIs, and thus seeks, through the Proposal, to do indirectly what it cannot do directly.

Third, by introducing a variety of costs and burdens, the Proposal risks either of two undesirable outcomes: (1) making it commercially unviable for qualified custodians to provide their services with respect to cryptocurrency assets; or (2) driving up consumer costs for such

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[8] *See Supplemental Information and Reopening of Comment Period for Amendments Regarding the Definition of "Exchange*,*"* SEC Release No. 34-97309 at 20 n. 54 (April 14, 2023) ("To date, no person has been approved to act as a special purpose broker-dealer custodying crypto asset securities.") *available at* https://www.sec.gov/rules/proposed/2023/34-97309.pdf.

services in a manner that harms investors. One particularly problematic example is the new requirement that RIAs enter into written agreements with their custodians. Custody is a low-margin business and the few entities that would likely be considered "qualified custodians" may not be willing to tolerate the costs of developing new forms, negotiating them with many different RIAs, putting into operation the various required provisions, and handling any resulting litigation. Qualified custodians will either exit the custody business or pass these additional costs onto customers.

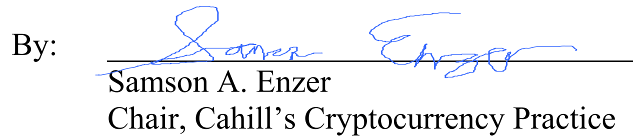
In another example, the Proposal requires that cryptocurrency assets held by a qualified custodian be verified each year by an independent public accountant except in narrow circumstances for assets that settle on a delivery-versus-payment ("DVP") basis. Assuming there are public accounting firms both familiar with cryptocurrency assets and willing to undertake this task in the first place, the cost of these annual examinations will be also be borne by customers. The narrow exception for assets that settle on a DVP basis does little to alleviate the new burden, and may in any event be impossible for RIAs to meet with respect to certain over-the-counter transactions.

At a minimum, the foregoing issues demonstrate that the brief comment period that the SEC has currently allotted for feedback on this Proposal is inadequate under the Administrative Procedure Act. *Cf. N.C. Growers' Ass'n* v. *UFW*, 702 F.3d 755, 770 (4th Cir. 2012) ("Our conclusion that the Department did not provide a meaningful opportunity for comment further is supported by the exceedingly short duration of the comment period."). Among the other issues that Galaxy has identified, but has not had adequate time to address during the current comment period, include that (1) the Proposal's definition of "possession or control" would likely result in fewer options for digital asset trading platforms, which may affect the quality of digital asset markets generally and conflict with an RIA's duty of best execution; (2) the Proposal effectively prohibits staking and the use of decentralized finance protocols; and (3) the potential that self-custody may be a safer option in some circumstances and should be treated as a viable option.

For all the reasons discussed above and others as to which Galaxy has not had adequate time to address, the SEC should extend the comment period for the Proposal, and should not adopt the Proposal in its current form.

Respectfully submitted,

CAHILL GORDON & REINDEL LLP

By: 
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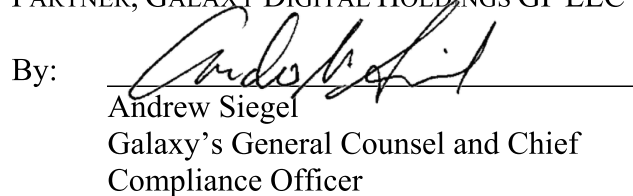
By: 
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