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May 8, 2023

VIA EMAIL (RULE-COMMENTS@SEC.GOV)

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: No. S7-04-23

Dear Ms. Countryman:

Equity Trust Company ("ETC") respectfully submits this letter in response to the request of the Securities and Exchange Commission ("SEC") for comment in connection with Investment Advisers Act Release No. 6240, dated February 15, 2023. That release proposes new rules and amendments to Rule 206(4)-2 (the "Custody Rule") under the Investment Advisers Act of 1940 (the "Advisers Act") that would expand the current Custody Rule to cover a wider variety of client assets and advisory activities and impose new custodial protections on client assets held under the Advisers Act (the "Safeguarding Proposal").

ETC acknowledges that the Safeguarding Proposal attempts to fulfill one of the core components of the SEC's long-standing mission – namely, to protect investors. ETC unequivocally supports and shares this important goal. To that end, ETC provides the following comments to certain questions from the Safeguarding Proposal in furtherance of the SEC's mission and with an eye toward clarifying how ETC and other state-chartered trust companies may continue to help serve and protect investors.

Background on ETC

ETC has a longstanding track-record for client service and protection as a custodian and administrator of traditional and alternative asset classes for clients investing with investment advisers or through self-directed investment retirement accounts. Operating for approximately thirty years, ETC currently has a staff of approximately 400 employees operating across three offices to serve our clients and their over 237,000 custodial and administrative accounts. As a result of this growth, ETC now is one of the largest custodians of self-directed investment retirement accounts and serves over $39 billion in assets under custody and administration that are invested in real estate, private lending, private equity, foreign exchange trading, cryptocurrency, precious metals, mutual funds, and stocks. Given all this, ETC has extensive experience in custodying alternative investments through, among other things, the

implementation of our proprietary Digital Asset Platform that has allowed clients to invest in cryptocurrency since 2018.

As a non-depository trust company chartered in South Dakota, ETC is subject to extensive regulation and oversight that ensures that client assets are adequately safeguarded. ETC is overseen and examined by the South Dakota Division of Banking on a regular basis, and is subject to the Division of Banking's stringent safeguarding requirements. Given our regulatory status that grants ETC with broad fiduciary powers under South Dakota law, ETC also qualifies and serves as a nonbank custodian under the Internal Revenue Code. We take great pride in both distinctions and understand the significance of our role to our clients and the markets.

Recognizing the importance of our custodial and administration obligations, ETC has implemented overlapping layers of controls and oversight to safeguard client assets. For example, ETC is subject to an annual audit by an independent public accounting firm, Cohen & Company, in accordance with the standards of the American Institute of Certified Public Accountants, and has achieved a SOC 1, Type 1 certification. ETC also maintains an Internal Audit department that reports directly to the Audit Committee of our Board of Directors as well as trust committees appointed by the Board of Directors to oversee operations, custodial duties, and compliance with applicable law. And ETC maintains robust policies and procedures to comply with our safeguarding and other obligations as overseen by our trust committees and duly appointed Chief Information Security Officer.

In short, ETC follows both the letter and the spirit of the relevant laws when it comes to protecting our clients' assets, and fully supports the goal of the Safeguarding Proposal.

Safeguarding Proposal Comments

19. Should the rule continue to include banks as defined in section 202(a)(2) of the Advisers Act or savings associations as defined in section 3(b)(1) of the Federal Deposit Insurance Act as qualified custodians, as proposed? Should the rule narrow the definition to include only certain banks and savings associations as qualified custodians? If so, how? For example, should the rule permit only banks or savings associations that are subject to Federal regulation and supervision to act as qualified custodians? Alternatively, should the rule permit only state banks and savings association that are members of the Federal Reserve System to act as qualified custodians? Would narrowing of the types of banks and savings associations that meet the definition of qualified custodian provide additional protections to advisory clients in the event of the custodian's insolvency? Is there another way to achieve our policy goal?

The SEC should not narrow the types of entities that may serve as qualified custodians because doing so would be inconsistent with the Advisers Act, recent SEC actions, and the best interests of investors.

Instead, the SEC should recognize that state-chartered trust companies may serve as qualified custodians because the Advisers Act expressly notes that state-chartered trust companies may qualify as "banks". According to Section 202(a)(2) of the Advisers Act: "'Bank' means ... (C) any other ... ***trust company***, whether incorporated or not, ***doing business under the laws of any State*** or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency, and which is supervised and examined by State or Federal authority having supervision over banks or savings associations, and which is not operated for the purpose of evading the provisions of this title ...." (Emphasis added.) Yet, as currently drafted, the Safeguarding Proposal would depart from this clear statutory language.

Recognizing the ability of state-chartered trust companies to serve as qualified custodians would also be consistent with recent SEC actions. Several months before publishing the Safeguarding Proposal the SEC alleged in a consent order that a state-chartered trust company is a bank. *In the Matter of Great Plains Trust Company*, 2020 SEC LEXIS 4442, 2-4 (Sept. 30, 2022) (alleging that a Kansas chartered non-depository trust company regulated by the Office of the State Bank Commissioner of Kansas met the definition of a "bank" under Section 2(a)(5) of the Investment Company Act of 1940). Because that definition of "bank" is nearly identical to the Adviser Act's definition of bank, it would not make sense for the SEC to take different positions when interpreting and applying these sister statutes. Moreover, the SEC's allegation in that consent order is significant because it comes after the SEC's Division of Investment Management and Office of Strategic Hub for Innovation and Financial Technology sought and received comment from the industry on, among other things, whether state-chartered trust companies possess characteristics similar to those of banks.[1]

On the other hand, not recognizing the ability of state-chartered trust companies to serve as qualified custodians likely would harm investors by substantially narrowing the pool of entities that may serve this critical function thereby making it more expensive for investors. Because the Safeguarding Proposal proposes to broaden the types of assets under the SEC's purview, it would also needlessly prevent state-chartered trust companies from continuing to serve and protect investors where those trust companies now have expertise with these asset classes. Indeed, as investors have diversified their investments into a wider array of asset classes, ETC and other state-chartered trust companies have stepped in to serve these needs, particularly with respect to cryptocurrencies and other illiquid assets that traditional custodians have been historically reluctant to service. As a result, state-chartered trust companies have gained valuable experience and built proprietary systems to safeguard these assets, which present unique challenges that traditional systems and controls may not adequately address. Given this, state-chartered trust companies may be best positioned to serve and protect investors with respect to those assets.

This is particularly true when assessing state-chartered trust companies against what the Safeguarding Proposal identifies as the "critical components of safeguarding client assets under the proposed rule" – specifically, that the qualified custodians "operate under regular government oversight, are subject to periodic inspection and examination, have familiarity with providing custodial services, and are in a position to attest to customer holdings and transactions."[2] ETC and other state-chartered trust companies satisfy all of these components and should not unnecessarily be prevented from continuing to serve their clients based on a new rulemaking that is inconsistent with the Advisers Act.

Nor should the SEC favor foreign or federally-chartered trust companies over state-chartered trust companies as it appears to do in the Safeguarding Proposal. While the Safeguarding Proposal specifies the requirements by which a foreign trust company may serve as a qualified custodian,[3] it does not outline similar requirements for a state-chartered trust company to serve in this important role. In fact, as Commissioner Uyeda pointed out, the Safeguarding Proposal instead "further questions whether state-chartered trust companies" may serve as qualified custodians because they perhaps "are less trustworthy

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[1] SEC Division of Investment Management and Office of Strategic Hub for Innovation and Financial Technology, 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.

[2] SEC Proposed Rule, Safeguarding Advisory Client Assets, Rel. No. IA-6420, File No. S7-04-23 at 43 (Feb. 15, 2023) ("Safeguarding Proposal"), https://www.sec.gov/rules/proposed/2023/ia-6240.pdf,

[3] Safeguarding Proposal at 47-48.

than federally-chartered ones."[4] That is not the case. Given the foregoing, there is no reasonable basis to make these distinctions between types of trust companies and certainly not any that serves investors or markets. As Commissioner Peirce recently opined, the "role [of the SEC] is to protect investors and markets, not incumbents."[5] That remains true here.

Nevertheless, to the extent the SEC believes there is any ambiguity in the law (which we do not believe to be the case), ETC respectfully requests that the SEC revise proposed 275.223-1(d)(10)(i) as follows to confirm that state-chartered trust companies may serve as qualified custodians:

> "A bank as defined in section 202(a)(2) of the Advisers Act (15 U.S.C. 80b-2(a)(2))**,** ~~or~~ a savings association as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)) that has deposits insured by the Federal Deposit Insurance Corporation under the Federal Deposit Insurance Act (12 U.S.C. 1811) or **a state-chartered trust company either qualified under the Internal Revenue Code to act as a nonbank custodian or substantially engaged in exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency including non-discretionary custody where such custody is a fiduciary activity under the laws of the state in which the trust company is located**, provided that the bank**,** ~~or~~ savings association **or trust company** holds the client assets in an account designed to protect such assets from creditors of the bank or savings association in the event of the insolvency or failure of the bank**,** ~~or~~ savings association **or trust company** ...."

42. Do the types of financial institutions serving as qualified custodians under the current rule maintain client assets in a manner that would satisfy the proposed definition of "possession or control"? Do commenters agree with our view that the proposed definition of possession or control (i.e., being required to participate in any change of beneficial ownership) is consistent with how the concept of possession or control is understood currently by most qualified custodians and does not conflict with the requirements of qualified custodians' respective regulatory regimes?

The proposed requirement that qualified custodians have "possession or control" of assets such that they are required to participate in any change in beneficial ownership of those assets is practical and consistent with the purpose of the Custody Rule and related regulatory oversight. This proposed requirement is practical because it would uphold the "critical custodial function" of "prevent[ing] loss or unauthorized transfers of ownership of client assets."[6] It is also consistent with the SEC's stated intention of using an evergreen test because it would not dictate custodial terms that could quickly become obsolete or impractical depending on the type of asset or changes in technology. Instead, this approach is technologically neutral because it correctly recognizes "that a qualified custodian's participation in a change of beneficial ownership may take different forms depending on the type of asset involved."[7] As a result, this approach remains consistent with other regulatory guidance[8] as well as current best practices for

[4] Commissioner Mark T. Uyeda, Statement on Proposed Rule Regarding the Safeguarding of Advisory Client Assets (Feb. 15, 2023), https://www.sec.gov/news/statement/uyeda-statement-custody-021523.
[5] Commissioner Hester M. Peirce, Atomic Trading Speech (Feb. 22, 2021), https://www.sec.gov/news/speech/peirce-atomic-trading-2021-02-22.
[6] Safeguarding Proposal at 62.
[7] Safeguarding Proposal at 62.
[8] Safeguarding Proposal at 64 n.120 (citing Office of the Comptroller of the Currency, Interpretive Letter 1170, Authority of a National Bank to Provide Cryptocurrency Custody Services for Customers (July 22, 2020)).

custodying cryptocurrencies, including escrowing and sharding of private keys and employing multisignature wallets.

56. Should the rule include the due care reasonable assurances requirement? Is this standard of care common practice in the custodial marketplace and, if so, would custodians be willing to provide information to an adviser sufficient to satisfy the proposed rule? Instead of the proposed approach, should the rule require generally that an adviser obtain reasonable assurances that a qualified custodian meets certain minimum commercial standards and then specify some but not all applicable standards? Would the proposed requirement provide additional protections for clients when an adviser has custody of client assets and further the policy goals of the rule?

ETC respectfully requests that the SEC reconsider the proposed requirement that investment advisers enter into written agreements with qualified custodians. As the SEC itself recognizes, "an agreement between the custodian and the adviser would be a substantial departure from current industry practice."[9] This admitted departure is a significant jurisdictional overreach especially where custodians are already overseen by other regulators and subject to their own law. Yet the Safeguarding Release does not appear to contemplate whether existing regulations that directly apply to custodians provide the protections that the SEC now seeks or whether the proposed requirements would undermine or conflict with those existing regulations. For example, the South Dakota trust law imposes liability on trust companies for gross negligence or intentional misconduct,[10] whereas the Safeguarding Rule would impose liability for mere negligence. Nor does the Safeguarding Release appear to consider how such indirect regulation of custodians would impact the nature of the services that they would be able to provide or the increased costs that would undoubtedly be passed on to investors. As Commissioner Peirce aptly points out, the Safeguarding Rule "dictate[s] contract provisions involving entities the Commission does not regulate" and could "shrink[] the ranks of qualified crypto custodians" and make it more "costly" for investors.[11] Given all this, it would seem prudent to consider these points and whether the proposed requirement ultimately benefits investors.

ETC appreciates the opportunity to comment on the Safeguarding Proposal and continue our important work of serving and protecting investors. If you have any questions on this letter or if we can be of any further assistance, we would be happy to provide additional information.

Respectfully,

Elizabeth Curtis,
General Counsel

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[9] Safeguarding Proposal at 77.
[10] SDCL § 55-1B-4.
[11] SEC Commissioner Hester M. Peirce, Statement on Safeguarding Advisory Client Assets Proposal (Feb. 15, 2023), https://www.sec.gov/news/statement/peirce-statement-custody-021523.