May 28, 2024

Via E-mail (rule-comments@sec.gov)

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

Re: Safeguarding Advisory Client Assets (Release Nos. IA-6240, IA-6384; File No. S7-04-23; Fed. Reg. Nos. 2023–03681, 2023–18667)

Ms. Countryman:

Blockchain Association (the "Association") submits this letter in further response to the Securities and Exchange Commission's ("SEC") proposal to amend and replace Rule 206(4)-2 (the "Custody Rule") under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), with Rule 223-1 (the "Proposed Rule").

The Association is the leading nonprofit membership organization dedicated to promoting a pro-innovation policy environment for the digital-asset economy. The Association endeavors to achieve regulatory clarity and to educate policymakers, regulators, courts, and the public about how blockchain technology can pave the way for a more secure, competitive, and consumer-friendly digital marketplace. The Association represents nearly 100 member companies reflecting the wide range of the dynamic blockchain industry, including software developers, infrastructure providers, exchanges, custodians, investors, and others supporting the public blockchain ecosystem.

The Association previously submitted comment letters in response to the Proposed Rule on May 8, 2023 and October 27, 2023.[1] The Association submits this letter to highlight that the Proposed Rule's cost-benefit analysis rests on the flawed and unexplained assumption that most digital assets are already "securities" or "funds" subject to the existing custody rule.

Both the Administrative Procedure Act ("APA") and the Advisers Act require the SEC "to do what it can to apprise itself—and hence the public and the Congress—of the economic consequences of

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[1] Jake Chervinsky and Marisa T. Coppel, *Comment Regarding Safeguarding Advisory Client Assets (Release No. IA-6240; File No. S7–04–23; Fed. Reg. No. 2023–03681)*, Blockchain Association (May 8, 2023), https://tinyurl.com/2mr3nnrs; Marisa T. Coppel and Laura Sanders, *Comment Regarding Safeguarding Advisory Client Assets (Release No. IA-6384; File No. S7-04-23; Fed. Reg. No. 2023–18667)*, Blockchain Association (Oct. 27, 2023), https://tinyurl.com/5e97uk5v.

a proposed regulation before it decides whether to adopt the measure." *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005). That means that, among other things, the SEC must address all of the significant costs of its Proposed Rule, including its effects on "efficiency, competition, and capital formation." 15 U.S.C. § 80b-2(c). The Advisers Act specifically requires the SEC to "consider" those effects when engaged in rulemaking as part of "determin[ing] whether an action is necessary or appropriate in the public interest," *id.*, and those effects are unquestionably an "important aspect of the problem" that the agency cannot ignore under the APA, *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

The Proposed Rule seeks to dramatically expand the classes of assets to which the SEC's custody requirements apply. For more than sixty years, the SEC has regulated investment advisers' custody of only "securities" and "funds."[2] The Proposed Rule, however, would expand the SEC's custody authority to encompass *all* adviser "assets," including all digital assets.[3] Even if the SEC had statutory authority to make that change—and it does not—the APA and the Advisers Act would require the agency to identify and attempt to quantify the full costs of regulating digital-asset custody, and to weigh those costs against the purported benefits of the rule.[4] Yet the Proposed Rule "fail[s] to adequately address the increased costs that the Proposed Rule will impose on qualified custodians, investment advisers, and ultimately, investment clients," as the Association has explained.[5]

That failure derives in part from a flawed assumption underlying the Proposed Rule's cost-benefit analysis. In the Proposed Rule, the SEC asserted for the first time that the existing custody rule *already* applies to most digital assets because, in the agency's view, "most crypto assets are likely to be funds or crypto asset securities" subject to the existing rule.[6] The SEC then proceeded to consider the costs of the Proposed Rule only for "those advisers (and their clients) with custody of crypto assets that are *not* funds or securities subject to the current custody rule."[7] In other words, the SEC zeroed out most of the costs that the Proposed Rule would impose on the digital-asset industry by assuming that the existing custody rule already imposes those costs.

That analysis does not withstand scrutiny. The SEC's assertion that "most" digital assets are securities or funds represents a recent and misguided course reversal. For years, the SEC stated

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[2] *See Custody or Possession of Funds or Securities of Clients*, 27 Fed. Reg. 2,149 (Mar. 6, 1962).

[3] 88 Fed. Reg. 14672-01, 14,678-79 (Mar. 9, 2023).

[4] *See* Coppel et al., *Comment Regarding Safeguarding Advisory Client Assets* at 5-6, Blockchain Association (May 8, 2023), https://tinyurl.com/2mr3nnrs.

[5] Coppel et al., *Comment Regarding Safeguarding Advisory Client Assets* at 5, Blockchain Association (Oct. 27, 2023), https://tinyurl.com/5e97uk5v; Coppel et al., *Comment Regarding Safeguarding Advisory Client Assets* at 18-19, Blockchain Association (May 8, 2023), https://tinyurl.com/2mr3nnrs.

[6] 88 Fed. Reg. at 14,676.

[7] *Id.* at 14,742 (emphasis added).

that it had at most limited authority to regulate digital assets as securities.[8] Only recently has the agency taken a much more sweeping view of the securities laws' scope—a view that is gravely wrong and is the subject of multiple, ongoing lawsuits.[9] And even in those lawsuits, the SEC has offered varying and conflicting theories for its jurisdictional expansion.[10] The agency's position that an unspecified number of digital assets are "funds" under the existing custody rule is of a similarly recent vintage, appearing for the first time in a footnote of the Proposed Rule. And it is similarly ill-conceived. The existing custody rule that refers to "funds" was adopted in 1962—nearly half a century before digital assets were invented—and the term always has been understood to refer to traditional forms of money used to buy securities.[11] Nor is it clear how the agency's new positions square with its longstanding acknowledgment that some digital assets, including the most prevalent digital assets (Bitcoin and Ether), are commodities rather than securities or funds.

For years, the digital-asset industry has justifiably (and correctly) understood, based in part on the SEC's representations, that most digital assets are *not* securities or funds subject to the current custody rule. The Proposed Rule would upset that reliance and impose significant costs on a far broader swath of the digital-asset industry than the SEC has assumed in its cost-benefit analysis. The agency cannot blind itself to those costs by relying on its newfound, ever-changing, and specious interpretations of the securities laws. The agency instead must consider the costs that the Proposed Rule would impose on the digital-asset industry assuming that most digital assets are *not* securities or funds, consistent with the economic reality. *See, e.g.*, *Chamber of Commerce*, 412 F.3d at 144; *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009).

The SEC also must offer a reasoned explanation for its assertion that most digital assets are securities or funds covered by the existing custody rule. This requires the agency to first articulate a coherent theory of its asserted authority over advisers' custody of digital assets, including reasoned explanations of which digital assets it believes to be securities and which digital assets it believes to be funds. Then, the agency must attempt to determine the extent to

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[8] William Hinman, Dir., Div. of Corp. Fin., SEC, *Digital Asset Transactions: When Howey Met Gary (Plastic)* (June 14, 2018), https://tinyurl.com/ycss4mhu (a digital asset "all by itself is not a security"); *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide*, Part III, 117th Cong. 1, 12 (May 6, 2021), https://tinyurl.com/mr4ypvfy (Chair Gensler: "the exchanges trading in these crypto assets do not have a regulatory framework either at the SEC, or our sister agency, the Commodity Futures Trading Commission").

[9] *See, e.g.*, *SEC v. Coinbase, Inc.*, No. 23-cv-4738 (S.D.N.Y.); *SEC v. Payward, Inc.*, No. 23-cv-6003 (N.D. Cal.); *SEC v. Binance Holdings Ltd.*, No. 23-cv-1599 (D.D.C); *LEJILEX v. SEC*, No. 24-cv-168 (N.D. Tex.); *Consensys Software Inc. v. SEC*, No. 24-369 (N.D. Tex.).

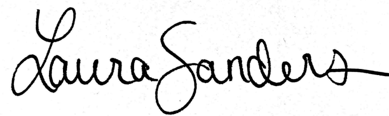
[10] *Compare SEC v. Payward, Inc.*, No. 23-cv-6003 (N.D. Cal. 2024), ECF 26-1 at 18:23 (Hearing Tr. from Coinbase enforcement action) (digital asset itself is just "computer code," not an investment-contract security), *with id.* ECF 26-2 at 92:14-15 (Hearing Tr. from Binance enforcement action) (digital asset itself "represents the investment contract").

[11] *See Custody or Possession of Funds or Securities of Clients*, 27 Fed. Reg. 2,149 (Mar. 6, 1962); Coppel et al., *Comment Regarding Safeguarding Advisory Client Assets* at 5, Blockchain Association (Oct. 27, 2023), https://tinyurl.com/5e97uk5v.

which digital assets *held by investment advisers* (rather than by the general public) constitute securities or funds, in the agency's view. And it must give the public an opportunity to comment on those matters. The Proposed Rule does none of this. Instead, it offers only a footnote citing *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946), and asserting that "even if a particular crypto asset is not a security, the current rule also covers funds."[12] That does not cut it under the APA.

The Association urges the SEC to revise and reissue the Proposed Rule in light of these considerations. We welcome the opportunity to discuss our comments with the SEC and its staff.

Respectfully submitted,



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[12] 88 Fed. Reg. at 14,676 n.29.