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Congress of the United States
House of Representatives
Washington, DC 20515

May 18, 2023

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Dear Chair Gensler,

We write today regarding the Securities and Exchange Commission's (SEC) proposed rulemaking that would amend and redesignate rule 206(4)-2, the Commission's custody rule under the Investment Advisers Act of 1940. Specifically, question 19 on page 14685 of the proposed rule in the Federal Register asks if the final rule should be changed to permit "only banks or savings associations that are subject to Federal regulation and supervision to act as qualified custodians?" The current custody rule includes both state-chartered banks and state-regulated trust companies as eligible to be qualified custodians. We strongly urge you not to further limit the pool of eligible qualified custodians in the final rule.

Custody of assets for registered investment adviser (RIA) clients is a core banking activity. It follows that such an activity should be subject to banking rules and regulations under our longstanding dual-banking system, which allows for state and national banks to operate on equal footing. The status quo relating to the dual-banking system has been upheld previously by the SEC. When the qualified custodian requirement was adopted in 2003, the Commission specifically allowed for banks conducting custody services, including state-chartered banks, to qualify.[1]

Further, state regulators have comprehensive rules that provide substantive consumer protection and regulatory requirements in this area. Uninsured state trust companies have prudently offered custody services for centuries. States, like New York, have successfully supervised these services for just as long. Trust companies are subject to exacting regulations that protect consumers, including capital and liquidity standards, "know your customer" requirements, and state resolution laws—with or without federal supervision.[2] Regulations for the Nebraska Financial Innovation Act—which allows certain state-chartered banks to custody digital assets— are still being written by the Nebraska Department of Banking. However, the law

[1] SEC, *Custody of Funds or Securities of Clients by Investment Advisers*, Advisers Act Rel. No. 2176, 68 FR 56691, at 56693 (Oct. 1, 2003)
[2] 23 CRR-NY Pt. 200 (Virtual Currencies)

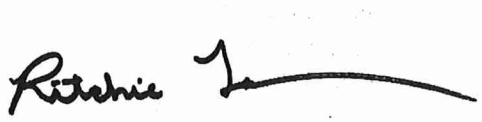
explicitly requires digital asset depositories to follow know-your-customer requirements, maintain capital requirements and follow the Bank Secrecy Act among other provisions. [3]

While question 19 indicates that narrowing the definition of qualified custodians could provide additional protections for advisory clients, we fear it would do the opposite. Given the very small number of digital asset custodians in the marketplace, excluding state-regulated institutions from becoming qualified custodians would lead to greater market concentration and adversely affect competition. Additionally, as the rulemaking itself notes, it "could cause investors to remove their assets from an entity that has developed innovative safeguarding procedures for those assets, possibly putting those assets at a greater risk of loss."[4]

Further narrowing the definition of qualified custodian to only federally-regulated savings associations and banks would adversely affect investor protection and market competition. When finalizing this rule, we strongly urge you to continue to allow for state-chartered banks and state-regulated trust companies to operate as qualified custodians.

Sincerely,

Michael J. Flood
Member of Congress



Ritchie Torres
Member of Congress

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[3] Neb. R. Stat. § 8-3001 to 8-3031

[4] *Safeguarding Advisory Client Assets*, Advisers Act Rel. No. 6240, 88 FR 14672, at 14742 (March 9, 2023)