

THE REVIEW OF  
**SECURITIES & COMMODITIES  
REGULATION**

AN ANALYSIS OF CURRENT LAWS AND REGULATIONS  
AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

Vol. 56 No. 10 May 24, 2023

## RESPONDING TO THE SEC STAFF ON THE CUSTODY OF DIGITAL ASSETS UNDER THE 1940 ACT

*Several years ago, the SEC staff requested feedback on whether a registered fund investing in digital assets could satisfy the 1940 Act's custody requirements. In this article, the author suggests a response to the SEC staff's custody question that draws heavily from SEC rules and SEC staff no-action letters.*

By Susan Gault-Brown \*

On January 18, 2018, the then-Director of the Division of Investment Management at the Securities and Exchange Commission (“SEC”) sent a letter to two major asset management industry trade groups, the Investment Company Institute and the Asset Management Group of the Securities Industry Financial Markets Association, entitled: “Engaging on Fund Innovation and Cryptocurrency-related Holdings.”<sup>1</sup> In this letter, the SEC staff invited the industry groups and any interested registered fund sponsors to engage with the staff on a number of issues under the Investment

Company Act of 1940 implicated by the holding of digital assets by registered funds. Among these issues was custody, specifically how a registered fund investing in digital assets could “satisfy the custody requirements of the 1940 Act and relevant rules?”

In addition to posing questions, the letter also asked the industry to discontinue all registrations of registered funds seeking to invest in digital assets, stating that “[u]ntil the questions identified above can be addressed satisfactorily, we do not believe that it is appropriate for fund sponsors to initiate registration of funds that intend to invest substantially in cryptocurrency and related products, and we have asked sponsors that have registration statements filed for such products to withdraw them.”

This has essentially been the state of play since the 2018 letter was issued. The issues raised in the letter – including the issue of how the holding of digital assets by a registered fund could comply with the 1940 Act’s custody requirements – have not yet been, at least in the SEC staff’s view, “addressed satisfactorily.”

This article provides a deeper dive into the SEC staff’s custody question, asking whether there is a path to compliance under the current custody provisions of

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<sup>1</sup> Staff Letter: Engaging on Fund Innovation and Cryptocurrency-related Holdings (Jan. 18, 2018), available at <https://www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm>. See related letters dealing with custody of digital assets under the Investment Advisers Act of 1940: Engaging on Non-DVP Custodial Practices and Digital Assets (March 12, 2019), available at <https://www.sec.gov/investment/non-dvp-and-custody-digital-assets-031219-206>; Staff Statement on WY Division of Banking’s “NAL on Custody of Digital Assets and Qualified Custodian Status” (Nov. 9, 2020), available at <https://www.sec.gov/news/public-statement/statement-im-finhub-wyoming-nal-custody-digital-assets>.

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