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Client Alert

FinTech, Crypto, Trading & Markets

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Trust Me, I'm a Bank: SEC Provides Relief for State Chartered Trust Companies Acting as Crypto Asset Custodians

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What You Need To Know:

- The staff of the SEC's Division of Investment Management (the Staff) have issued no-action relief to registered investment advisers (RIAs) and registered funds (Funds) wishing to use state-chartered trust companies (State Trust Companies) to custody Crypto Assets and Cash and/or Cash Equivalents reasonably necessary to effect transactions in Crypto Assets.
- Subject to certain conditions, the Staff will not recommend enforcement if RIAs and Funds treat State Trust Companies as "banks" under Section 202(a)(2) of the Advisers Act and Section 2(A)(5) of the 1940 Act, respectively, for purposes of custody of Crypto Assets and Related Cash and/or Cash Equivalents.[1]

Traditional Custody Requirements

Under Rule 206(4)-2 of the Advisers Act (the Custody Rule), RIAs with custody of client funds or securities must maintain those assets with a "qualified custodian," which includes a bank, broker-dealer, futures commission merchant, or foreign financial institution meeting specified criteria. Similarly, under Section 17(f) and Section 26(a) of the 1940 Act, Funds are required to maintain securities and other investments in the custody of a bank meeting certain statutory qualifications.

In both instances, the definition of "bank" includes State Trust Companies so long as, among other things, "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." Given the facts and circumstances nature of this requirement, meaningful uncertainty has pervaded the industry as to which State Trust Companies satisfy the definition of "bank." Therefore, RIAs and Funds have largely eschewed using State Trust Companies to satisfy their custody obligations under the Custody Rule and 1940 Act, respectively.

Crypto Asset Revolution

As investors, markets, and technology service providers have rapidly embraced Crypto Assets, traditional custodians have failed to meet the demands of the industry, having been broadly hamstrung by a lack of clear regulatory guidance from state and federal regulators regarding the regulatory treatment of Crypto Asset custodial services. This state of affairs has left RIAs and Funds engaging in, or hoping to engage in, Crypto Asset strategies without effective custody solutions. In contrast to traditional bank, broker-dealer, or futures commission merchant custodians, State Trust Companies have had greater flexibility to implement Crypto Asset-focused custodial solutions. State Trust Companies have developed specialized practices for Crypto Asset custody, including secure private key management, segregation of client assets, and robust cybersecurity programs, all of which have made State Trust Companies an important component of the Crypto Asset custody framework (albeit, until recently, largely inaccessible to RIAs and Funds).

State Trust Company Custody

The Staff makes clear that it would not recommend enforcement action if RIAs and Funds treat State Trust Companies as banks for the purposes of placing and maintaining Crypto Assets and Related Cash and/or Cash Equivalents, provided that certain "key conditions" are met.

Key Conditions:

The ability for RIAs and Funds to treat State Trust Companies as banks is conditioned on the following:

1. The RIA or Fund must have a reasonable basis to believe, initially and annually, that the State Trust Company:
    a. is authorized by its state banking authority to provide custody of Crypto Assets; and
    b. maintains policies and procedures to safeguard Crypto Assets (including key management and cybersecurity).

2. In order to make the determination in b., the RIA or Fund must receive and review the State Trust Company's audited financial statements and current independent internal-control reports (e.g., SOC-1/SOC-2 with opinion).

3. The RIA or Fund must enter into, or cause one of its clients to enter into, a custodial services agreement with the State Trust Company that:

    a. prohibits the lending or pledging of Crypto Assets and Related Cash and/or Cash Equivalents absent written client or Fund consent; and
    b. segregates Crypto Assets and Related Cash and/or Cash Equivalents from the State Trust Company's own property.

4. RIAs must disclose to their clients, and Funds must disclose to the members of their boards, as applicable, the material risks associated with using a State Trust Company to maintain custody of Crypto Assets and Related Cash and/or Cash Equivalents.

5. The RIA or Fund must reasonably determine that the use of a State Trust Company to maintain custody of Crypto Assets and Related Cash or Cash Equivalents is in the best interest of the RIA's clients or the Fund and its shareholders.

This relief will expand available portfolio options for RIAs, particularly for clients seeking stablecoin exposure, and dovetails with the recently enacted GENIUS Act, which establishes a federal framework for payment stablecoins and explicitly permits State Trust Companies to issue such assets. Taken together, these developments underscore the evolving role of State Trust Companies in the Crypto Asset ecosystem. This relief is the most recent in a long line of positive guidance and continued policy momentum toward a more durable Crypto Asset regulatory regime.

Despite cheers from the industry, Commissioner Caroline Crenshaw criticized the relief as creating a dangerous loophole in the established custody framework, warning that by blessing State Trust Companies to act as qualified custodians for Crypto Assets through the SEC's no-action process and without formal rulemaking, the SEC risks weakening investor protections, sidestepping statutory guardrails, and leaving client assets vulnerable to gaps in oversight.[2] Luckily, the SEC is considering rulemaking regarding Crypto Asset custodial requirements for RIAs and Funds–to the relief (we presume) of Commissioner Crenshaw and the industry alike.[3]

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[1] As noted in the relief, "Crypto Assets" refers to assets that are digital representations of value that are recorded on a cryptographically secured distributed ledger, while "Related Cash and/or Cash Equivalents" means "cash and/or cash equivalents reasonably necessary to effect transactions in Crypto Assets"

[2] *See* SEC.gov | Poking Holes: Statement in Response to No-Action Relief for State Trust Companies Acting as Crypto Asset Custodians.

[3] *See generally* Spring 2025 Unified Agenda of Regulatory and Deregulatory Actions, available at https://www.reginfo.gov/public/do/eAgendaMain.

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