

SEC and FINRA Staffs Highlight Broker-Dealer Regulatory Challenges Raised by Digital Assets—And Hint at Solutions

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Broker-dealer custody of on-blockchain assets has been a key hurdle in the development of a more regulated financial infrastructure for digital assets in the United States. In a [joint statement](#) (the **Joint Statement**), the staffs of the SEC and FINRA outlined their concerns about broker-dealers' ability to comply with their financial responsibility rules—in particular, the requirement to obtain and maintain physical possession or control of fully-paid and excess margin securities—for business activities involving digital assets that are securities. The Joint Statement hints at a possible path forward for broker-dealers who pursue a business model that does not result in a broker-dealer having custody of customer digital assets.

Background. Over the past several years, the SEC has issued many public statements and taken enforcement actions indicating that certain digital assets are securities. A firm involved in effecting transactions in such assets may need to register with the SEC as a broker-dealer. A number of firms in the digital asset industry have sought to register or acquire broker-dealers and obtain approval from FINRA to engage in digital asset securities business.

These efforts have met with little success. The unsettled nature of the regulatory treatment of digital assets, and in particular how the broker-dealer financial responsibility rules apply to them, have prevented firms from demonstrating to FINRA that they can engage in digital asset activities in compliance with SEC rules. Doing so is a necessary step to obtain FINRA's approval. These firms have thus been placed in a difficult position—they cannot lawfully engage in digital asset securities business without registration, but without further guidance from the SEC and FINRA on the financial responsibility rules, they are not able to engage in the business in a registered capacity.

Highlighting regulatory challenges. For the most part, the Joint Statement does not resolve these uncertainties. Instead, it explains in some detail the “novel and complex regulatory and compliance questions and challenges” raised by broker-dealers' engaging in digital asset securities business and the related regulatory considerations under the Securities Exchange Act of 1934. Most significantly, under Rule 15c3-3, the “Customer Protection Rule,” a broker-dealer that holds fully paid or excess margin securities on behalf of customers must safeguard those assets by obtaining, and then maintaining, physical possession or control of those securities. In addition, traditional securities custody infrastructure has permitted unauthorized transactions to be reversed or cancelled—something that may not be possible with digital assets held on an immutable blockchain.

The staffs raised several concerns that could arise from broker-dealers maintaining custody of digital assets on behalf of customers:

- Digital assets may be difficult to recover in situations where a broker-dealer is victimized by fraud or theft, private keys for digital asset wallets are lost, or digital assets are sent to an incorrect address.
- Even if a broker-dealer can prove that it holds a private key, that may not be sufficient to evidence possession or control, as this does not prove that no third party also has the private key.
- Whether a broker-dealer can provide evidence of the ownership or existence of digital assets sufficient to maintain required books and records of securities holdings and prepare financial statements and reports.

- Whether a broker-dealer can prove ownership of digital assets sufficient to obtain required audited financial statements.

The Joint Statement also describes concerns raised by digital asset securities activities under the Securities Investor Protection Act of 1970 (**SIPA**), which provides for certain customer protections in the insolvency of a broker-dealer—including a priority claim over general creditors for customer property. These protections apply to “securities” and cash deposited for the purpose of purchasing “securities,” as defined in SIPA. The SIPA definition excludes “investment contracts” that are not registered under the Securities Act of 1933. Digital assets that are investment contracts, if not registered under the Securities Act, would not be eligible for protection under SIPA—a result many customers may not anticipate.

Hinting at a solution. The Joint Statement suggests that the SEC and FINRA may be willing to permit broker-dealers to engage in digital asset securities activities through a non-custodial business model, as those models “do not raise the same level of concern.” This could involve a broker-dealer arranging a digital asset securities transaction but not intermediating settlement of the transaction or coming into possession of the parties’ digital asset securities.

Those models include:

- *Private Placement Model.* This would be similar to a typical private placement business—where a broker-dealer arranges transactions between an investor and an issuer, but the transactions settle directly between the parties.
- *Secondary Market OTC Transactions.* A broker-dealer may arrange an over-the-counter trade between a buyer and a seller, but similar to the private placement model, the parties settle the transactions directly between themselves without the securities passing through the broker-dealer.
- *Alternative Trading System with Third-Party Custodians.* A broker-dealer operates a trading platform registered as an alternative trading system (**ATS**), but matched trades are reported to and settled directly between the buyer and seller or their custodian(s)—without the ATS guaranteeing settlement or maintaining control over investors’ securities.

The staffs indicated that they will engage in efforts to resolve their concerns with broker-dealer digital asset activities under the Customer Protection Rule and SIPA, and that they “stand ready to continue to engage with entities pursuing this line of business” while “continu[ing] their constructive engagement with market participants.” That said, it may be that firms respond by pursuing non-custodial models, given that appears to be a clearer regulatory path for broker-dealers to engage in digital asset securities activities.

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