SEC Rulemaking Update
Proposed Custody Rule Modernization and Crypto Custody Framework

On October 1, 2026, the Securities and Exchange Commission (SEC) proposed comprehensive amendments to the custody rules under the Investment Advisers Act of 1940 (Advisers Act) and the Investment Company Act of 1940. The proposal would remove Rule 206(4)-2 (the Custody Rule) and repropose it as new Rule 223-1 under Section 223 of the Advisers Act, which imposes an affirmative obligation on advisers to safeguard client funds and securities. The proposal would also create what Chairman Paul Atkins described as "a compliant pathway where none existed before" for advisers and regulated funds to custody crypto assets and would make several practical changes to the existing rule of direct interest to private fund managers. The proposal follows the SEC's withdrawal of the 2023 Safeguarding Rule proposal and takes a narrower, more targeted approach.

Key Changes for Private Fund Audits and Accountants

- Elimination of PCAOB Requirement – Accountants performing private fund audits, surprise examinations, and internal control reports would no longer need to be registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board (PCAOB), but would still need to be independent under Regulation S-X. The SEC stated that PCAOB registration and inspection "are not an appropriate proxy" for audit quality.
- Extended Delivery Deadlines – Audited financial statements would remain due within 120 days of fiscal year end for most funds, extended to 180 days for funds of funds and 260 days for funds of funds of funds. A delay from reasonably unforeseeable circumstances generally would not violate the rule if the adviser reasonably expected timely delivery and delivers promptly.
- Non-U.S. Funds – Audited financial statements would follow U.S. GAAP, but funds organized or managed outside the United States could use other standards if U.S. investors receive a reconciliation of material differences to U.S. GAAP.
- Newly Formed Funds – A pooled vehicle formed within 90 days before its fiscal year end could deliver unaudited financial statements for that period within 90 days after year end, with the next audit covering both periods.

Other Proposed Changes to the Custody Rule

- Standing Letters of Authorization – Custody arising solely from a qualifying standing letter of authorization would be excepted from the surprise examination requirement, codifying and superseding the 2017 staff no-action position.
- Discretionary Trading Authority – Custody arising solely from discretionary trading authority would be excepted if the adviser cannot transfer assets to itself, its related persons, or other non-client accounts without client direction. This may ease the custody analysis for private fund interests, loans, derivatives, and foreign assets.
- Inadvertent Custody – Unwanted custody authority arising solely from a client's custodial agreement would be excepted if the adviser did not recommend, request, or require it and, upon learning of it, repudiates the authority and requests its removal in writing.
- Form ADV – Item 9 and Schedule D would be revised to distinguish having custody from relying on an exception; add questions on crypto self-custody, state trust companies, and tokenized private funds (also applicable to exempt reporting advisers); and remove the PCAOB questions.

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- Custodian Notice Account Number – Advisers to unaudited private funds, and other advisers with custody, must notify clients or LPs upon opening an account with a qualified custodian. The notice currently must include the custodian's name and address, and the proposal would also require the account number.
- Accommodation Statements – Statements from a custodian that reports private investments or other holdings on an "accommodation basis" without truly taking custody (for example, for an unaudited private equity fund or co-investment vehicle) would need to clearly disclose, among other things, that the custodian does not hold or have authority to obtain those assets.

Crypto Asset Custody Framework

The crypto provisions apply only to crypto assets that are client funds or securities, and advisers will need to analyze coverage in light of the SEC's March 2026 crypto asset interpretation. Tokenized securities would be treated as securities, and tokenized deposits and certain payment stablecoins as funds, while digital commodities may not be covered and may require different treatment.

- State Trust Companies – Qualifying state trust companies would become permitted custodians for crypto assets, subject to initial and annual due diligence on the company's state authorization, safeguarding policies, audited financial statements, and internal control report, and segregation of client assets.
- Adviser Self-Custody – An adviser could self-custody client crypto assets only if it determines in writing, before custody begins and at least quarterly, that no permitted custodian is available for the asset (cost is not a valid basis). Conditions include documented safeguarding expertise, private key controls requiring at least two designated individuals (including a management person) to approve transfers, segregated blockchain addresses for each client, annual cybersecurity assessments and reviews, an annual internal control report from an independent public accountant (the first within six months), quarterly client statements, and a written client agreement to treat the assets as "financial assets" under state law, which for funds could require limited partnership agreement or side letter changes.

Under either framework, the annual surprise examination or the audit alternative for pooled vehicles would continue to apply. Crypto assets held with a qualifying state trust company would be subject to the same notice and account statement requirements as other qualified custodians. For self-custodied assets, those requirements would be replaced by adviser-delivered quarterly statements, except for audited pooled vehicles and regulated funds. The proposal does not include exceptions for assets held on trading platforms or decentralized finance activity, or reduced requirements for smaller advisers.

Next Steps

Comments are due December 7, 2026, and we will continue to monitor the proposal. Most changes would apply on the final rule's effective date, although the SEC asked whether a six-month or one-year compliance period is needed. A final rule would also supersede inconsistent staff positions, including certain no-action letters. In the interim, advisers should:

- Inventory custody arrangements, custodian notices and statements, and SEC positions relied upon, including standing letters of authorization and the 2025 state trust company no-action letter.
- Evaluate auditor engagement and fiscal year planning in light of the proposed audit provisions.
- For crypto assets, compare current custody practices to the proposed conditions.

Fact Sheet – https://www.sec.gov/files/ia-7023-fact-sheet.pdf
SEC Release – https://www.sec.gov/files/rules/proposed/2026/ia-7023.pdf