

## Lowenstein Crypto

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**A Step Forward for Broker-Dealers and Transfer Agents Engaged in Crypto Asset Businesses**By [Ethan L. Silver](#), [William Brannan](#), and [Leo B. Choi](#)**What You Need To Know:**

- The staff of the Securities and Exchange Commission's (SEC) Division of Trading and Markets (the Staff) releases [frequently asked questions](#) (FAQs) addressing the Staff's views relating to crypto asset activities and distributed ledger technologies.
- The FAQs provide incremental guidance for broker-dealers, transfer agents, and issuers of crypto assets with respect to operational, custody, net capital, and securityholder recordkeeping activities.

**Broker-Dealer Financial Responsibility***Crypto Asset Custody and Proprietary Trading*

The Staff noted that Securities Exchange Act (SEA) Rule 15c3-3(b) only applies to securities carried by a broker-dealer. Accordingly, if a broker-dealer carries non-security crypto assets (e.g., Bitcoin or Ether), a broker-dealer will not be required to maintain crypto assets in the manner set forth under the rule.

Additionally, broker-dealers are not prohibited from facilitating in-kind creations and redemptions in connection with spot crypto exchange-traded products (ETPs). However, the Staff notes that if a broker-dealer takes a proprietary position in the assets underlying an ETP, it would need to account for those assets when calculating its net capital. Further, the Staff indicated that Bitcoin and Ether may be considered readily marketable for purposes of determining whether the 20 percent haircut applicable to commodities under SEA Rule 15c3-1 applies.

*Insolvency Protection for Crypto Assets*

Under the Securities Investor Protection Act of 1970, only securities that are the subject of a registration statement are covered under the protection of the Securities Investor Protection Corporation (SIPC). Therefore, crypto asset securities and non-security crypto assets fall outside SIPC protection so long as there is no effective registration statement for such crypto assets.

In the event of a broker-dealer's insolvency, although SIPC protection does not apply to crypto assets generally, the Staff suggests that broker-dealers consider whether it would be appropriate to agree with their customers that non-security crypto assets will be treated as "financial assets" and carried in a "securities account" under Article 8 of the Uniform Commercial Code, thereby helping shield customer assets from the broker-dealer's estate in the event of insolvency.

## *Other Considerations*

The Staff views a broker-dealer's recordkeeping practices as vital for a broker-dealer engaged in a non-security crypto asset business. Accurate books and records can assist a broker-dealer during an audit or examination and ensure that customer non-security crypto assets are properly segregated in the event of a broker-dealer's liquidation. Although this is not a requirement, the Staff suggests a broker-dealer could keep the same records for its non-security crypto asset business as it does for its securities business.

## **Transfer Agents**

### *Crypto Asset Transfer Agent Registration*

In the context of crypto asset securities, whether a transfer agent is required to register with the SEC depends on, among other things, if it is providing services for an issuer of crypto asset securities that are registered under Section 12 (Section 12 Securities) of the SEA. Therefore, transfer agents should consider whether the securities are Section 12 Securities and analyze whether the services, functions, or activities they perform fall within one of the enumerated activities under Section 3(a)(25) of the SEA (e.g., among other activities, registering the transfer of securities and transferring record ownership of securities via book entry).

### *Master Securityholder Files*

With respect to registered transfer agents, the Staff affirmed that a blockchain ledger can be utilized as a registered transfer agent's official master securityholder file as defined under SEA Rule 16Ad-9(b), provided other requirements are met. As a result, a transfer agent would not be required to maintain a duplicate or "digital twin" of its master securityholder file exclusively off-chain. The Staff also confirms that a transfer agent's master securityholder files can utilize both on-chain and off-chain components. For example, a securityholder's wallet address, asset balance, date of purchase, and transaction ID can be maintained on-chain, while personally identifiable information such as an investor's name, address, or tax identification number can be kept off-chain.

## **Takeaways**

The FAQs provide welcome guidance and insight into how foundational broker-dealer and transfer agent obligations apply in the rapidly evolving crypto asset regulatory environment. While the FAQs confirm that many existing regulatory principles remain unchanged, they may provide market participants with added certainty as they explore various crypto asset functions. Firms engaged in or contemplating engaging in crypto asset businesses should review their operational and regulatory systems to ensure compliance with existing customer protection rules and review whether current disclosures adequately capture insolvency risks and SIPC coverage. Transfer agents providing services to issuers of crypto asset securities should review whether their use of multiple systems, including a blockchain ledger, are consistent with their obligations under SEA rules.

Lowenstein Sandler has significant experience advising broker-dealers, transfer agents, and other financial institutions across a broad range of regulatory matters. Please contact one of the listed authors of this Client Alert or your regular Lowenstein Sandler contact if you have any questions regarding the application of existing rules and regulations to your current or proposed crypto asset business.

## Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

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