The Real Estate Roundtable

"Safeguarding Rule" Withdrawal

Capital and Credit

Summary

In 2023, the U.S. Securities and Exchange Commission (SEC) proposed changes to require SEC-registered investment advisers to put all their clients' assets, including all digital assets like Bitcoin and certain physical assets like real estate, with "qualified custodians." The proposal would have required a written agreement between custodians and advisers, expanded the "surprise examination" requirements, and enhanced recordkeeping rules. These rules were originally designed for digital assets. The proposal's "reasonable" safeguarding requirements are ambiguous as applied to real estate. Furthermore, the SEC's release contained an inaccuracy regarding the way deeds evidencing ownership of real estate are recorded. RER opposed the proposed rule on real estate and pushed for an exception for real estate.

Following extensive industry pushback, particularly regarding its application to real estate, digital assets, and the high compliance costs for small firms, the SEC issued a notice on June 12, 2025, withdrawing the proposal.

Key Takeaways

The withdrawal of the SEC's proposed "Safeguarding Rule" in June 2025 is a major relief for the real estate industry. The proposal would have categorized physical real estate as a client "asset" requiring a qualified custodian, a requirement industry groups called "preposterous" and "unworkable."

- **Avoidance of Impossible Custody**: Real estate assets cannot be physically "held" in a bank vault or brokerage account. Ownership is instead maintained through deeds and mortgages recorded at local government offices. The withdrawal prevents a conflict where advisers would have been required to place these physical assets with custodians who were often unwilling or unable to accept them.
- **No Mandatory Independent Verification for Every Transaction**: The proposed rule would have required an independent public accountant to verify **every purchase, sale, or transfer** of a real estate asset within one business day. This would have introduced significant delays and high costs to real estate closings.
- **Preservation of Existing Safeguards**: Real estate remains governed by the original 2015 Custody Rule, which generally does not apply to a real estate partnership's physical assets unless the partnership itself is an advisory client. Existing state and local laws for recording deeds and mortgages continue to serve as the primary protection against misappropriation.
- **Reduced Compliance Costs for Smaller Advisers**: Smaller real estate investment firms avoided the "death by a thousand cuts" described by RER, including expensive new surprise audits and written custodial agreements that would have been required under the expanded scope.
- Capital formation is vital when credit markets tighten to restructure maturing debt.

Background

Current Regulatory Status

- The SEC has shifted toward its **"ACT" (Advance, Clarify, Transform) framework**, which prioritizes clear, workable rules over the broad "catch-all" approach of the withdrawn safeguarding proposal. For real estate advisers, this means a return to traditional fiduciary duties and standard bookkeeping without the specialized custodial mandates originally proposed in 2023.
- The **SEC Custody Rule (Rule 206(4)-2)**, as established in its 2015-compliant framework, applies to any Registered Investment Adviser (RIA) that has "custody" of client funds or securities. For **Real Estate Investment Trusts (REITs)** and their advisers, compliance primarily centers on how the entity is structured—specifically whether it is treated as a **pooled investment vehicle**.