



July 9, 2019

Paul G. Cellupica
Deputy Director and Chief Counsel
Division of Investment Management
Securities & Exchange Commission
Washington, DC

RE: “Custody Rule and Digital Assets”

Dear Mr. Cellupica,

Per the request for comments on the letter entitled “Engaging on Non-DVP Custodial Practices and Digital Assets” I would like to provide thoughts from Prime Trust on select questions.

As a technology-driven, Nevada chartered trust company, Prime Trust has been deeply involved in working with broker dealers, investment advisors, securities issuers, crowdfunding portals, real estate syndicators, cryptocurrency exchanges and others in both traditional and emerging digital markets. We have, for many years, provided escrow services to Reg A, D, S, CF and other traditional securities offerings. We enable customers, including self-directed IRA’s and other account types, to purchase private securities, cryptocurrency and other assets for their accounts, which we hold on their behalf. We offer extensive KYC and AML compliance services. And we enable ATS’ and other exchanges to affect and settle transactions of private securities and cryptocurrency for accounts we custody.

I would like to comment on a few select questions from the letter referenced.

What role do custodians play in the settlement process of Non-DVP trading?

Secondary transactions in private securities, as well as cryptocurrency, are fraught with risk when conducted directly by individual owners. Custodians can mitigate this risk for private securities and cryptocurrency similar to what they do with public, DTC-registered securities. This is because custodians effectively replicate the DVP process by holding assets, ensuring payment is received and cleared, and then permitting the transaction to occur. The issue has always been that traditional custodians, including both clearing brokers and trust companies, have been unwilling to custody securities which are not DTC eligible, and unwilling to custody digital (tokenized) assets and cryptocurrency. However, a new generation of custodians, which includes Prime Trust, are building the technology and infrastructure to provide custody and settlement services and enable market participants to eliminate systemic risks and inefficiencies.

What role do (custodians) play in mitigating risks of misappropriation of loss arising from such trading?

By settling transactions only upon receiving into custody the funds and the assets, custodians eliminate the risk of counterparties failing to fulfill their side of a transaction. Thus the investor is protected since their assets never leave custody unless the counterparty fulfills their obligations. Also, as regulated entities, the customers are far better protected than if they use unregulated custodians such as crypto exchanges, software and hardware wallet providers, and other entities both domestic and global purporting to offer custody solutions for digital assets.

To what extent do Non-DVP assets appear on client account statements from qualified custodians?

To a trust company it doesn’t matter whether the assets are cash, publicly traded stock, private stock, public or private debentures, fractional interests (e.g. tokenized asset), cryptocurrency, or real estate. They are just asset classes, and all of them appear on customer statements.

To what extent does an investment adviser have any influence over, or input into whether and how such assets appear on account statements?

None. Prime Trust maintains sole and exclusive control over what appears on customer statements and how the information is presented. No third-party, including investment advisers, have any control or ability to change this.

Are there any assets that trade on a Non-DVP basis that would not appear on a qualified custodian's account statements?

No. All assets that Prime Trust holds in custody are displayed on statements.

To what extent could evolving technologies, such as blockchain/distributed ledger technology (“DLT”) provide enhanced or diminished client protection in the context of Non-DVP trading?

From a custodian's perspective, when it comes to “custody” the form of the security is practically irrelevant when it comes to custody. An equity asset might be represented by a physical stock certificate, a book-entry confirmation from an issuer or transfer agent, or a token on a blockchain.

Now, that said, when it comes to “settlement”, and in particular cross-custodian settlement, blockchain provides an interesting opportunity for counterparties to work together to efficiently and safely settle transactions without the need for a DTC-like infrastructure.

If individuals effect transactions directly, without using a custodian, then it doesn't matter whether the asset ownership is evidenced by a physical certificate or a token as there is a risk of a counterparty not fulfilling their part of a transaction.

What challenges do investment advisers face in complying with the Custody Rule with respect to digital assets?

We don't see why there would be any challenges. Digital assets are “assets”. All assets must be held by a qualified custodian. Qualified custodians can hold assets in digital form, just as they do assets in physical and other forms.

To what extent do investment advisers use state-chartered trust companies...to custody digital assets?

Currently state-chartered trust companies such as Prime Trust are the only qualified custodians in the US who are willing to custody non-DTC eligible assets, including private securities, cryptocurrency and assets where the ownership is evidenced by tokens on a blockchain (“digital”) instead of paper certificates.

What is the settlement process for intermediated transactions in digital assets...?

It is not very different than settlement of transactions of non-digital assets.

1. A customer requests a transaction, either directly or via their investment adviser.
2. The transaction may be posted to a securities exchange, a cryptocurrency exchange, a direct counterparty, or other participant.
3. The custodian holds assets until receipt of counterparty assets, and then fulfills the transaction on behalf of the customer. Where the counterparty is another qualified custodian, such as a trust company or clearing broker, the registered parties may cross-settle simultaneously or rely on one or the other to perform settlement and remit funds or assets to the other.
4. The transaction is posted by the custodian to the customer's statement.

To what extent do investment advisers construe digital assets as “securities”...?

No party other than the Commission and the courts have authority to deem any asset to be a security (or not). An asset is either a security or it's not. This is true regardless of the form of evidence of ownership (physical, book-entry or token).



To what extent can DLT be used more broadly for purposes of evidencing ownership of Securities?

For direct registration, that being securities held by an individual in their possession and not by a custodian, then DLT can make it easier for them to hold instead of paper certificates. An issuer will need to ensure that the smart contract enforces disclosure of holders' information and not enable anonymous wallets. Regardless, holding any asset directly instead of via a custodian creates risk of loss or misappropriation for investors.

Conclusion:

Custodians can (and will) play a crucial role in the evolution of the markets in providing liquidity for private securities and other non-DTC assets. These firms, generally trust companies, provide a safe and efficient ecosystem for customers to hold assets, and for market participants to create alternative forms of evidencing ownership (e.g. tokens) and of providing mechanisms for secondary liquidity for private securities. In short, these custodians help ensure market integrity and maximize investor protection.

Sincerely,

Scott Purcell
CEO, Chief Trust Officer