REPUBLIC CAPITAL

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May 5, 2023

Via Email to rule-comments@sec.gov

Ms. Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release No. IA-6420; File No. S7-04-23
Safeguarding Advisory Client Assets

Dear Ms. Countryman,

Republic Capital Adviser LLC (collectively with its affiliates and subsidiaries, "Republic Capital") respectfully submits this letter in response to the request for comment by the Securities and Exchange Commission (the "Commission"), on its proposed rulemaking regarding Safeguarding Advisory Client Assets (the "Proposal"). We thank the Commission for its efforts in publishing the Proposal and the opportunity to provide our comments.

Republic Capital supports the spirit and intent of the Proposal, however, we believe that adoption, in its current form, could lead to many unforeseen and unintended externalities. Under the current Proposal's language, an adviser will likely be forced to balance, uncomfortably, its fiduciary duties with its compliance obligations under the Investment Advisers Act of 1940 ("Advisers Act"). For example, the Proposal, if adopted without changes, would impose significant implementation costs - costs which would ultimately be borne by investors. Additionally, we believe the Proposal invites issues of practicality when considering items like the additional requirements to qualify as a domestic qualified custodian, the substantial increase in the requirements to qualify as a foreign financial institution ("FFI") and the Commission's Outsourcing Proposal that is contemporaneously being considered for adoption.[1]

In addition to the above-mentioned concerns, the Proposal does not sufficiently address how an adviser may maintain compliance while exploring or implementing novel uses for client assets. One such oversight relates to digital assets[2], which can be staked. In such cases, an adviser may need to choose between having a qualified custodian exert control over the asset in a manner which disallows staking, thereby allowing the asset's value to fall, subject to dilution caused by other like assets being staked, *or* staking the asset in a fashion where a qualified custodian is not in control of the position, taking steps to increase or maintain the value of client assets, but running afoul of compliance with the Proposal in the process. Moreover, like

[1] See Release Nos. IA-6176; File No. S7-25-22, Outsourcing by Investment Adviser, October 26, 2022 (the "Outsourcing Proposal").
[2] As the Proposal expands the custody rules to "positions", references to "digital assets" herein are agnostic as to whether such digital assets are securities, commodities or assets of an unregulated nature.

Commissioner Peirce[3], we believe the implementation timeline proposed will be difficult, if not impossible, for smaller advisers to adhere to, especially given that the Proposal represents a "substantial departure from current industry practice."[4] Smaller advisers may not have sufficient leverage with custodians to receive the necessary assurances in the timeline proposed; this concern compounded by the prospect of advisers concurrently or chronologically putting such third-parties through material diligence to comply with the Outsourcing Proposal.

Republic Capital agrees with the Commission, the safeguarding of client assets must be paramount, but this goal must be weighed against cost-benefit analysis, the likelihood of fraud or fault, and the existence and expansion of the fund-audit rule which provides for material assurances as to the safeguarding of said assets. Principally, Republic Capital implores the Commission to consider amending the proposed exemption from the qualified custodian requirement for such assets that an adviser reasonably believes cannot be custodied by a qualified custodian to be less asset focused and centered more around facts and circumstances; allowing advisers to do what is best for their clients under the circumstances of their situation, rather than within a vacuum of regulatory analysis of an asset's qualities. Finally, if adopted without changes, we believe doubling the implementation period, to at least two years, will be necessary for smaller advisers and industry participants to align with the Proposal.

I. Republic Capital's business and its advisory with respect to novel assets

Republic Capital is an SEC-registered investment adviser and wholly owned subsidiary of OpenDeal Inc., dba Republic, the owner and operator of a family of companies (the "Republic Group"). The Republic Group includes a SEC-registered crowdfunding portal, a SEC-registered broker-dealer, exempt reporting advisers, a United Kingdom Financial Conduct Authority regulated financial intermediary, a blockchain and cryptography advisory business and a game development platform financing its ventures through Regulations A and D. The Republic Group is in the business of servicing and facilitating a wide range of offerings exempted from registration under the Securities Act of 1933, as amended (the "Securities Act"). Republic was founded with the two-sided goal of helping founders, traditionally underserved by venture capitalists, broker-dealers and the private equity community, find funding and support; which in turn allows everyday Americans to become "angel investors" in companies they believe in, real estate projects in their communities and video games that they play with their friends and family.

Republic Capital represents the institutional arm of the Republic Group via its investment advisory business, which organizes and advises private funds (collectively referred to as its clients) each pursuing opportunities in compelling private investments. Republic Capital has about 300 clients and less than one-billion dollars under management; making it a smaller registered adviser; clients are comprised of private funds pursuing the following models: (i) single-purpose vehicles which complete investments in one instrument issued by one issuer (traditionally called a syndicated special purpose vehicle or "SPV") and (ii) multi-asset close ended funds which may invest in and hold a variety of assets from a variety of issuers over the course of their lifecycles.

The majority of the assets held by Republic Capital's clients, which constitute Republic Capital's regulatory assets under management, are privately offered securities subject to current Rule 206(4)-(2)(b) ("uncertificated private securities"). Increasingly, Republic Capital finds itself advising clients which have an interest in novel digital assets and/or securities issued by foreign private companies, each, to which the current custody rules are not well suited. In Republic Capital's experience, foreign issuers increasingly request that the securities they issue be held by a custodian of their designation to comply with their own regulatory and administrative requirements, and in many cases, even issuers of traditional convertible equity

[3] See Statement on Safeguarding Advisory Client Assets Proposal by Commissioner Hester M. Peirce, February 15, 2023.
[4] See Proposal at 77.

instruments such as convertible notes and SAFEs, include instruments like "token warrants" which provide the holder the ability to acquire a novel digital asset issued by the issuer if and when certain events occur. In Republic Capital's experience, the constantly evolving nature of alternative financing instruments results in issuers frequently issuing novel assets, for which there is no qualified custodian at the time of issuance, or to which the cost of engaging a qualified custodian would represent a material amount, often equal to, or even exceeding, the value of the asset Republic Capital seeks to protect. Republic Capital takes its fiduciary duties to protect its clients' assets seriously and has seen the industry adapt, absent firm guidance from the Commission, to satisfy its fiduciary duties to clients for many novel assets; however, Republic Capital believes the Proposal's highly prescriptive nature may stifle advisers dealing in emerging asset classes despite their commercial best efforts to meet the letter of the law and achieve an optimal outcome for their clients. Republic Capital is enthused the Commission is reflecting on and taking steps to address these issues and concerns, but, as mentioned in the preamble to this letter, believes the Proposal's broad scope and dictatorial nature will ultimately cause client harm and push smaller advisers out of the registered investment adviser space.

II. Assets subject to the Proposal

The Proposal's breadth will provide much-needed certainty as to the application of the Advisers Act with respect to assets under management. While we expect many market participants to decry the Commission's expansion of the scope of the Advisers Act to all "positions", we believe the Proposal is pragmatic and aligned with Congressional intent.[5] That being said, and as further explained below, we believe the additional proposed requirements pertaining to status as a qualified custodian and the proposed exemption from the requirement to engage a qualified custodian should be rationalized. For example, the Proposal specifies that physical assets are within the scope of the proposed rules in all events.[6] However, as the Commission is well aware, some of these assets may be acquired incidentally, may be of low or nominal value, may be without paper title to evidence control, and/or may be physically difficult to transport; yet the Proposal would require they be held by a qualified custodian absent an adviser proving a negative conclusion, i.e., that the asset could not be custodied.[7]

We believe this approach will lead to advisers incurring high, unnecessary, costs with respect to certain physical assets – those costs ultimately borne by investors. To take this concern to an extreme, imagine, if you will, an adviser that comes into possession of an expensive, heavy, but fragile, industrial refrigerator in association with the windup of portfolio investment. The refrigerator will eventually be liquidated and the cash distributed to the applicable client, but at the time of acquisition, it is an asset owned solely by control, i.e., possession; there is no title. Being a luxury good, the right buyer must be found to maximize value; there is no over-the-counter market for this lavish icebox. The asset can be custodied by a qualified third-party custodian, technically, but doing so may prove to be unreasonable as it would cost a great sum. The asset would likely need to be moved to a custodian's physical location for safeguarding and then said custodian must incur costs to safeguard it, provide access to facilities to, and the ability to, service the item or, if in good working order, maintain its good working order, and hold proper insurance – not to mention the contracting requirements now imposed on custodians as described in detail below. Adding to the adviser's concern, any form of audit as to the asset's existence would likely require an onsite visit by an auditor, at further expense. What is an adviser to do? To maximize value to the client and meet its fiduciary duties, the adviser would be best served having temporary custody of the asset, until it is liquidated – but doing so would not qualify for the custody exemption as currently proposed. While this hypothetical refrigerator issue may seem remote, it encapsulates the concerns we have about the breath of the rule. As

[5] See proposed rule 223-1(d)(1).
[6] See Proposal at 28.
[7] We discuss our concerns with the expanded exemption to the carve out for proposed rule 223-1 in sections III and V of this letter.

discussed below, we do not believe amending the definition of applicable assets is necessary; rather, we believe the scope of the exemption (requiring that a position is controlled by a qualified custodian if possible) should be changed to consider whether control of a position by a qualified custodian is practical and in the best interest of the client, in order to address these edge cases.

III. Qualifying as a Qualified Custodian

a. Generally

The Proposal makes numerous material alterations to the requirements advisers must impose on those parties acting as a qualified custodian. With respect to the universal requirements; first, per a written agreement between the adviser and the qualified custodian, the qualified custodian would be required to (i) provide promptly, upon request, records relating to clients' assets held in the account at the qualified custodian to the Commission or to an independent public accountant engaged for purposes of complying with the safeguarding rule; and (ii) to record in said agreement the adviser's level of authority in effecting transactions in the safeguarded assets.[8] We think these are pragmatic and reasonable requirements *provided* the agreement with the qualified custodian covering these issues should be by and between the *client* and the qualified custodian, as it is outside of the normal course for advisers to contract directly with qualified custodians. As the Commission knows ". . . under existing market practices, advisers are rarely parties to the custodial agreement, which is generally between an advisory client and a qualified custodian."[9] Therefore, the Proposal would further complicate the relationship between client and qualified custodian by inserting the adviser into a contract to which they are not typically a party. Many private funds are controlled by an affiliate of the adviser, acting as a general partner, manager or equivalent. By requiring the adviser, itself, to enter into a written agreement with a qualified custodian and obtain certain assurances, also in writing, additional contracting would be necessary, incurring additional costs for advisers, which would be indirectly passed to their clients. Further, these requirements may cause liability issues for advisers which have purposefully structured their businesses so as to not have management authority over assets and are compensated solely for advice and research.

With respect to the second requirement (each qualified custodian obtaining a written opinion of an independent public accountant regarding the adequacy of the qualified custodian's controls), we believe this exceeds the Commission's authority, as it seeks to impose requirements directly on to parties to which the Commission may have no regulatory or supervisory claim. For example, with certain domestic custodians and FFIs, such requirements may impose unnecessary costs due to existing government audit functions. Further, the results of such reports may be highly sensitive in nature and a prospective qualified custodian may be unwilling or unable to share the full report. Without a way to review the full report, an adviser may not be able to satisfy itself of the Proposal's engagement requirements, and by extension, the Outsourcing Proposal.[10] We also wonder what the proper cadence of acquiring the audit would be and what the results of a custodian's failure to secure or renew an audit would have on clients and their advisers. Would a qualified custodian's tardiness in undergoing an annual audit remove its status as a qualified custodian instantly, therefore rendering the adviser out of compliance? If the audit is highly sensitive, will an adviser be able to simply rely on representations as to its existence? Additionally, we believe this requirement will increase internal costs for certain custodians, which will increase the cost incurred by clients, ultimately reducing client returns.

In the same vein, as proposed, the Proposal's statutorily framed custody agreement would oblige the qualified custodian to send account statements to each client at least quarterly and provide the client with a written internal control report that includes the opinion of an independent public accountant who is

[8] See Proposal at 22 and proposed rule 223-1(a)(1).
[9] See Proposal at 74.
[10] See the Outsourcing Proposal generally and propose rule 205(4)-11 specifically.

registered with the Public Company Accounting Oversight Board ("PCAOB"). We cannot estimate, but are aware of the presence of, incremental cost which will affect each advisory client and their beneficial owners. Further, the attempt to use the PCAOB for a purpose Congress did not assign to it is concerning, as it presents the Commission as acting beyond its authority. Finally, the requirement that a custodian agree to provide to the Commission certain books and records, even if such custodian is not a registry of the Commission, creates problems Commissioner Peirce alluded to when she asked, "who would be on the hook if a qualified custodian failed to satisfy these requirements?"[11] A rule that isn't enforceable against the parties it is meant to regulate is not worth the space it occupies on the printed or digitally synthesized page.

b. Bank and Savings Associations

As previously mentioned, we have a great deal of concern as to the costs associated with the Proposal's implementation and such costs' detrimental effect on advisers' clients when balanced against the protections those costs may impart on their assets. Additionally, we believe many of the Proposal's requirements will reduce the number of qualified custodians servicing the private securities space, rather than encouraging new players into an already underserviced space. We believe the Proposal's requirement " . . . that a bank or savings association hold client assets in an account . . . designed to protect such assets from creditors of the bank or savings association in the event of the insolvency or failure of the bank or savings association . . ." in order to qualify as a qualified custodian[12] will make holding cash and other fungible assets unattractive to banks. Many smaller banks cover their costs through earning a spread from the leverage and arbitrage of their deposit accounts; the Proposal would require banks and other savings institutions to effectively segregate client assets from their general assets, and remove one of the few incentives for them to custody certain fungible assets outside of any additional fees charged to the named owner, i.e., the client. While we appreciate that the Commission's ultimate goal is to provide assurances to advisory clients that in the unlikely event of a bank or saving institution's insolvency, recovering client assets may be easier, this is in sharp contrast to industry practice and investor expectations.[13] Further, the Proposal, if implemented, will likely push many advisers to move cash into other forums, such as money market accounts or other liquid instruments, which would be subject to different custody regimes and risks, possibly defeating the purpose of the Proposal.

c. Foreign Financial Institution

In the Commission's 2003 Custody Rule Final Rule Release[14], the Commission stated "[w]here an adviser selects a foreign financial institution to hold clients' assets, we believe the adviser's fiduciary obligations require it either to have a reasonable basis for believing that the foreign institution will provide a level of safety for client assets similar to that which would be provided by a "qualified custodian" in the United States *or* to fully disclose to clients any material risks attendant to maintaining the assets with the foreign custodian." Therefore, the current definition of "qualified custodian" includes any "foreign financial institution that customarily holds financial assets for its customers, provided that the foreign financial institution keeps the advisory clients' assets in customer accounts segregated from its proprietary assets." Accordingly, as "Foreign Financial Institution" intentionally wasn't defined further or more specifically,

[11] See Statement on Safeguarding Advisory Client Assets Proposal by Commissioner Hester M. Peirce, February 15, 2023 and Proposal at 101. Further, we ask the Commission to consider whether the Outsourcing Proposal's commentary is now contradicted by this Proposal given advisers would be party to contracts with custodians, see Outsourcing Proposal at 21.

[12] See Proposal at 44.

[13] See Silicon Valley Bank's recent failure as a prime example of industry practice. Further, even in instances of assets held in a way that would not be subject to creditors of the bank, a bank's failure will lead to a delay or costs to the adviser to recover client assets, especially if they are of an untraditional nature.

[14] See Release No. IA-2176; File No. S7-28-02, Custody of Funds or Securities of Clients by Investment Advisers. Emphasis added by drafter.

the Commission's initial proposed release contained a fulsome definition, and it was eliminated in the final rule to allow the term to be interpreted broadly.

The Proposal is a total about-face from the Commission's prior views on FFIs. Specifically, the requirement that FFI's avail themselves to the laws of the United States and comply with anti-money laundering and related provisions similar to those of the Bank Secrecy Act, and regulations thereunder, will likely exclude many smaller FFIs as well as FFIs dealing in untraditional assets. Further, the Proposal imposes the unreasonable requirement that an adviser determine the prospective-FFI has the "requisite financial strength to provide due care for client assets."[15]

In the first instance, the Proposal would " . . . require the adviser to determine that the adviser and the Commission are able to enforce judgments, including civil monetary penalties, against the FFI."[16] This is a difficult requirement for any adviser to meet, especially as matters of enforceability are determined by courts, effected by domestic and international law, and are subject to changing facts and circumstances. Further, a prospective-FFI engaging a domestic registered agent would not guarantee the ultimate enforceability of any judgement against such prospective-FFI. We question what would occur, and what would the effect on the adviser be, if this determination proved false at a later date. Who would bear the responsibility?

In the second instance, the Commission's commentary on the requirement a prospective-FFI comply with anti-money laundering and related provisions similar to those of the Bank Secrecy Act and regulations thereunder is contradicted by stating that "[w]e generally believe an FFI would be able to satisfy this condition if it is required to comply with the laws and regulations established by a member or observer jurisdiction of the Financial Action Task Force ("FATF") and not otherwise listed on any sanctions list administered by the Office of Foreign Assets Control of the U.S. Department of the Treasury ("OFAC") or on any special measures list administered by the Financial Crimes Enforcement Network of the U.S. Treasury ("FinCEN")."[17] We do not believe this standard is consistent with the stated requirement, nor would it work for many prospective-FFIs that do not directly comply with OFAC or FinCEN if the assets they custody are generally not governed under the regulatory framework of those regimes. For example, if an adviser's client came into possession of an asset in a jurisdiction such as China or India, having a national bank custody the asset would likely not satisfy the requirement, despite meeting the previous FFI definition. In other instances, custodians of novel items, such as collectibles, may not traditionally subject themselves directly to such regimes. In either event, the Proposal would impose undue burdens onto advisers with emerging markets and international alternative investment practices.

In the last instance, the Commission's commentary states a belief that an adviser could make a financial strength determination "based on objective measures and other indicators of financial health that are reasonably comparable to those that apply to U.S. banks and other regulated financial institutions."[18] However, this assumption is unreasonable and assumes domestic (and international) qualified custodians are transparent with their financial conditions. Further, contracting with a prospective-FFI to inform an adviser of a declining financial condition is impractical, as many third parties would not agree to such requirements, nor would they be likely to uphold the contract in times of financial stress. As asked before, if a prospective-FFI was deemed to not be financially sound after it had been acting and reasonably relied upon as an FFI, what would that adjudication look like, and how would this affect an advisers' previous

[15] See Proposal at 48 and proposed rule 223-1(d)(10).
[16] See Proposal at 48 and proposed rule 223-1(d)(10).
[17] See Proposal at 50 and proposed rule 223-1(d)(10).
[18] See Proposal at 51 and footnote 106; we highlight that the Commission's assumption is based on the implication that an FFI would be a bank; however, as contemplated elsewhere, an FFI could be a non-bank and therefore not subject to regulatory capital requirements or be subject to regulatory capital requirements that do not satisfy a financial soundness inquiry alone.

reliance on said prospective-FFI? These questions are left unanswered by the Proposal and the Commission's dicta.

IV. **Defining "Custody"**

As the Commission acknowledged " . . . the custodial market for privately issued securities is less developed" than that of the public markets.[19] In Republic Capital's experience, this is an understatement. The custody market is currently experiencing a contraction of players due to high costs and low upside.[20] Despite the Commission stating a "[belief] that some custodians presently custody these assets and . . . understand that new custodial services are being developed." Republic Capital has searched for and is unaware of viable emerging market participants, especially with respect to private securities which take a digital form.[21] Further, in certain situations, Republic Capital has faced issuers that require a custodian of their own selection be used in order to meet the other business goals or regulatory requirements of said issuer. In such cases, if such custodian does not meet the letter of the Proposal, the adviser would be forced to choose between regulatory compliance and the best interest of its clients. This is because the Proposal focuses on the outright ability of the asset to be custodied by a qualified custodian rather than a facts-and-circumstances-oriented test that looks beyond the sole characteristics of the asset.

We agree with the Commission that a broad and practical definition of custody is centered on the ability to change title, i.e., "holding assets such that the qualified custodian is required to participate in any change in beneficial ownership of those assets." We would suggest that the term "holding" is inapplicable to many intangible assets and would recommend the restriction of the definition to exerting necessary influence or gatekeeper functions on any asset in any context.[22]

As the Commission knows, banks are the most common qualified custodians. We question how the Commission believes it is reasonable to impose requirements on banks and similarly situated institutions which may prospectively custody digital assets when only one nationally chartered bank can currently do so, and, such bank will not engage with advisers and their clients in New York State due to state law concerns.[23]

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[19] See Proposal at 15 and FN 21 which states that "many qualified custodians will not currently accept custodial liability for certain instruments including certain crypto assets, commodities, and privately issued securities."

[20] For example, Prime Trust, an early player in the securities crowdfunding business has stated its intent to discontinue providing custody services to privately issued securities and their issuers as well as discontinue providing escrow services for the same industry.

[21] See Proposal at 15 and FN 21 which states that "many qualified custodians will not currently accept custodial liability for certain instruments including certain crypto assets, commodities, and privately issued securities."

[22] See Proposal at 21 and proposed rule 223-1(d)(8). Possible alternative language could be "having the requisite power or authority to be required to participate in any change in beneficial ownership of assets."

[23] The Commission seems to acknowledge this in footnote 120 of the Proposal by quoting the OCC's cautionary note to banks " . . . seeking to engage in these activities . . .", reminding them to " . . . conduct legal analysis to ensure the activities are conducted consistent with all applicable laws.") see Interpretive Letter 1170, Authority of a National Bank to Provide Cryptocurrency Custody Services for Customers (July 22, 2020), available at https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1170.pdf. See also, Federal Reserve, *Policy Statement on Section 9(13) of the Federal Reserve Act* (Jan. 27, 2023) (*to be codified at* 12 C.F.R. § 208.112), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230127a.htm where the Board of Governors of the Federal Reserve System restricted the activities of uninsured state member banks to be the same as insured state banks, which practically deters uninsured state banks from seeking membership in the Federal Reserve System as a way to engage in novel activities, such as those involving crypto-assets, and obtain access to Federal Reserve services (e.g., payments through FedWire) and foreclosing a number of crypto-asset activities for all state member banks. Further, the business license for virtual currency activities, issued by the New York State Department of Financial Services (NYSDFS) has added an additional hurdle for many financial institutions and service providers looking to service advisers based in New York State, of which a large plurality are.

With respect to custody and control of digital assets, we are concerned with the Commission's acknowledgement that the manner in which most digital security exchanges operate would render an adviser non-compliant with the current and proposed custody rules.[24] The forums in which digital assets are traded and transact is an emerging issue with constantly shifting market players due to inconsistent rules and regulations worldwide.[25] As many exchanges and marketplaces are off-shore, the method and manner in which such forums of exchange allow for transactions will be largely determined by local law and custom; therefore the Proposal may create situations in which the only paths to liquidity for the client's assets are through incidental non-compliant custody of a digital asset in the pursuit of liquidation for the benefit of clients. While we understand the Commission's desire to protect client assets through all stages of an adviser's services to, and management of, a client, the custody definition, as proposed, could create illiquidity for client's assets and therefore cause harm in the name of avoiding fraud by advisers. However, as the Commission knows, if an adviser intends to steal from their clients, the current rules in place are almost immaterial as they will not prevent knowing bad acts.[26]

V. **Delivery of Account Statements**

Advisers to pooled investment vehicles are frequently affiliated with the general partners and managers of their advisee clients. Generally, advisers have auditors and custodians deliver account statements to their clients and make those statements available to the underlying beneficial owners of the pooled investment vehicles via email or web forum. The Proposal's requirement for an independent representative to receive the statements or for the qualified custodian to provide statements directly to the beneficial owners, to which they are likely not in privity with, adds unnecessary cost and no meaningful investor protection.[27] Further, as the delivery will require the exchange of personally identifying information of the underlying beneficial owners of the pooled investment vehicles to third-parties, there are possible privacy and data protection concerns and costs lurking and unexplored.

VI. **Privately Offered Securities and the Exemption From Utilizing a Qualified Custodian**

The current exemption from the custody rule for private uncertificated securities is insufficient for private capital markets which frequently rely on novel instruments that are frequently certificated and therefore not well applied to the current exemption. Such instruments run the gamut from SAFE instruments to novel digital assets. While the Commission states their belief that the " . . .bulk of advisory client assets are able to be maintained by qualified custodians . . ."[28] we respectfully disagree with regard to the assets frequently acquired by venture-style private fund advisers. That is not to say that we do not support the Commission's new proposed modifications to current Rule 206(4)-2(b); however, we believe they remain too narrow to properly address certain digital asset paradigms and issuer requirements. Specifically, we wish to address two situations we are aware of which exemplify why we believe the new proposed exemption should be expanded to be based on the facts and circumstances of how the adviser and its client come into possession

[24] See Proposal at 68.
[25] "At one extreme, authorities have prohibited the issuance or holding of crypto assets by residents or the ability to transact in them or use them for certain purposes, such as payments. At the other extreme, some countries have been much more welcoming and even sought to woo companies to develop markets in these assets. The resulting fragmented global response neither assures a level playing field nor guards against a race to the bottom as crypto actors migrate to the friendliest jurisdictions with the least regulatory rigor—while remaining accessible to anyone with internet access." see *Regulating Crypto* by Aditya Narian and Marina Moretti, International Monetary Fund, September 2022.
[26] See Footnote 11 of the Proposal.
[27] See Proposal at 98 and 99.
[28] See Proposal at 24.

of the position and what is best aligned with the client's financial interest, and not exclusively if a qualified custodian cannot custody the position.[29]

For example, consider staking. In certain cases, Republic Capital's clients are entitled to, or required to, acquire digital assets on top of the ones already held via a process known as "staking." Through the "staking" process, clients place their digital assets on a blockchain and receive additional digital assets based on the amount of time the assets are "staked" and the efficiency of the staking method. Staking is primarily an incentive mechanism to encourage participation in validating transactions on proof-of-stake networks, which in turn helps secure said networks. Holders of digital assets on proof-of-stake networks are motivated to stake their assets in order to avoid dilution of their relative holdings as a percentage of the total network supply. In such cases, the adviser may have to accept the additional digital assets in the method and manner required by the staking protocol, which may disallow any party to allow a different form of custody of the asset. In certain situations, the adviser's failure to stake its client's digital assets, especially at times where those assets are otherwise illiquid, could result in a potential loss of upside or even present value for clients due to staking's anti-dilutive benefits. However, in this paradigm, the adviser would not qualify for the proposed exemption due to the ability of a qualified custodian to potentially custody the underlying client asset. It is in this situation in which the manner the adviser gains control of the asset that controls its ability to be custodied, not the asset itself. This facts and circumstances issue is precisely what is overlooked by the Proposal.[30]

The Proposal is more problematic when it comes to certain physical assets. The Commission explains that land or a building would not be subject to the custody rule, but the deed or title would be.[31] However, this doesn't actually prevent theft or misappropriation. Take for example an adviser to a client that acquires an expensive vintage Ferrari as part of its diversified portfolio. Per the Proposal, the Ferrari itself may be subject to the exemption from the custody rule, but the title or bill of sale would not be. However, as readers of this letter well know, to steal a vehicle, one does not need the title or even the keys. While the adviser would have a duty to keep the Ferrari in a safe place and subject to controls on access, this would not provide the assurances against theft that the Commission is pursuing nor would the asset/position be subject to the need for a qualified custodian.

As the Commission states, "the current market for custodial services of privately offered securities is fairly thin . . . [and] many [prospective custodians] do not custody [positions]" which are held in nominee form.[32] Therefore, as previously discussed, we believe the reasonable determination test should not be based on whether ownership can be maintained by a qualified custodian in all situations, but as applied to the specific situations the adviser and its client find themselves in. We understand and appreciate the Commission's perspective, that being that a bearer of an instrument in any form will be considered certificated, however, the Proposal fails to account for facts and circumstances where the adviser and its client come into possession of a position in a method and manner not of their choosing. For example, certain issuers have specified specific FFIs (as defined by the current rule) to which their securities must be custodied; which, under the Proposal, would not be compliant, but to which the adviser would not have control to perfect or correct.[33] Further, an adviser would be compelled to study the "custodial

[29] We note that the test for whether an adviser can self-custody under this proposed rule provides numerous vagaries which could cause an adviser great uncertainty, including how long they can rely on the exemption and whether legal or economic impossibility is sufficient even if technical impossibility is not. Again, to quote Commissioner Peirce, "Proving a negative is difficult; it is unclear how frequently such a determination would have to be made or how far and wide would an adviser have to search for a qualified custodian for these securities?" See Statement on Safeguarding Advisory Client Assets Proposal by Commissioner Hester M. Peirce, February 15, 2023.

[30] As contemplated by proposed rule 223-1(b)(7) advisers generally have written authorization to conduct such activities.

[31] See Proposal at 136.

[32] See Proposal at 130.

[33] See Proposal at 135.

marketplace"[34] which may prove difficult or expensive. Finally, the length of time which this determination is valid is not specified; we would recommend it be revisited at least annually, when an adviser amends their Form ADV.

VII. **Concluding Thoughts**

The Advisers Act lays out the two basic fiduciary duties that all investment advisers owe to their clients: the duty of care and the duty of loyalty. An adviser must always serve the best interests of its client and cannot put its own interests ahead of the interests of its client. These are the principles by which all advisers should ultimately be judged. As discussed above, we believe the Commission should strongly consider revisions to the Proposal in order to allow advisers to follow these guiding principles rather than to balance them again overly prescriptive supplemental rules.

* * *

Thank you for the opportunity to comment on the Proposal. We are available to discuss our comments or any questions the Commission or its Staff may have.

Sincerely,

Maxwell R. Rich

Maxwell R. Rich

Deputy General Counsel and Vice President of Regulatory Affairs

cc: Adam Hull, Esq.
Veronica LeDuc, Esq.
Dania Piscetta, Esq.
Darren Sandler, Esq.

[34] See Proposal at 13.