DAR In Conversation: Q&A with Jack McDonald

As part of DAR's *September Crypto ETP Monthly Recap Report*, we've incorporated a guest post from Standard Custody & Trust Company. Our CEO Doug Schwenk had the chance to speak with Jack McDonald, CEO of PolySign and Standard Custody, to ask a few questions about institutional custody for digital assets.

Click to watch video highlights or scroll down to read the full transcript.

Doug: Why is third-party custody important in crypto?

Jack: Third-party custody is important in crypto for a lot of different reasons – and we can start by differentiating between institutions and retail.

Institutions, in many cases, have to use a qualified custodian as part of the custody rule. While the SEC has recently proposed some changes around [that mandate], if you fall into the rubric of the Registered Investment Advisers Act of 1940, you have to use a qualified custodian. Retail, however, does not [have to use a custodian]. That being said, having the heft of an institutional-grade custodian who has the infrastructure, the security, and the safeguarding measures in place, as well as the regulatory and insurance support behind, it is a best practice and will only become more so over time.

In traditional finance, qualified custodians can either be broker dealers regulated by FINRA, Futures Commission Merchants (FCMs) regulated by the Commodity Futures Trading Commission (CFTC), or trust banks regulated by state banking authorities. In digital assets or crypto, the only licenses that exist in the U.S. are state chartered trust companies and a few select FCMs. For spot trading for ETP providers, the only viable option is a qualified custodian via state-regulated trust companies.

Doug: What should institutional players think about when selecting a custodian?

Jack: When selecting a custodian, institutional investors should ensure there are operational and client support teams to service their needs. Institutions should also demand that their assets are insured. Even though it may not be a requirement, it's certainly a best practice.

Additionally, when selecting a custodian, investors should look at the custodian's service providers and vendors that they work with. Just like in life, we are judged by the company we keep.

Doug: As interest heats up in the U.S. crypto ETF space, who are the current players supporting the many recent filings in the custody space? And how should we think about differentiation?

Jack: One important market participant that comes to mind is Coinbase. They're in the unique position to offer exchange trading services and custody services, as well as the capability to offer a surveillance sharing agreement: essentially, an agreement between exchanges, regulators, and market surveillance providers to share trade data, order book information, etc. All are in the interest of providing more transparency and creating a fair trading environment. The SEC has pushed back on a number of the applicants to amend their filings to include these agreements.

While there is some concern among regulators and market participants that having all of those functions under one parent company or umbrella organization is not a best practice and may provide conflicts of interest, over time more providers will come into the space. At Standard Custody, we've built our business specifically to avoid any of these conflicts. We are exclusively focused on providing custody and escrow services. We don't provide any trading, staking, lending, borrowing, or market making functions. I think as you watch this industry unfold, you will see more pure play custodians like Standard Custody be selected by the issuers.

Doug: What is the future of custody in digital assets?

Jack: I've been telling people around PolySign that "boring is the new sexy." The events over the last year have highlighted the importance of "pure play" custody.

While it's not always the most exciting facet of capital market infrastructure, within the foreseeable future we are going to see a lot of innovation taking place with and around digital asset custodians. Many of the largest global asset management firms speak about this future: BlackRock, PIMCO, State Street, Citi, and BNY Mellon to name a few. They all agree that capital markets are going to profoundly change, and that digital assets will encompass a much broader set of assets than just cryptocurrencies.

One way or another, tokenization is coming and will have a profound impact on global markets. There will be an emerging democratization of finance that is different than we know it to be today, and custody will continue to be a cornerstone of this future. Other services that complement custody will also evolve over time. It is undeniable that custody of digital assets will fundamentally change the market.

Few ways to learn more:

- Click to see ***DAR's September Crypto ETP Monthly Recap Report*** *with a special report, "Elevating Trust: Crypto ETFs & Unconflicted Qualified Custodians" by Patrick Clancy, Head of Digital Asset Strategy at PolySign, Inc.*
- Sign up to receive DAR's ETP Monthly Recap Reports (free version)
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