

The background of the cover is a composite image. On the left, a suspension bridge (resembling the Golden Gate Bridge) spans across a deep canyon with steep, rocky walls. On the right, a large volcano with a prominent plume of white smoke or ash rises against a cloudy sky. The image is overlaid with a dark, semi-transparent geometric shape that contains the text.

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CRYPTO ASSETS: THE HOTTEST NEW TREND

PAT MULKERN, OF THEOREM FUND SERVICES, SPEAKS WITH SOME OF THE INDUSTRY'S SERVICE PROVIDERS ABOUT THE RISE OF CRYPTOCURRENCIES AND SERVICING THIS EMERGENT ASSET CLASS



Pat Mulhern is a director of Business Development at Theorem Fund Services. Mulhern has worked in sales in the financial industry for nearly 10 years. Prior to Theorem, Mulhern was a vice president in sales at SS&C and Citco, in charge of generating new business across the US. Mulhern holds a Bachelor's degree from Penn State University with a Finance major and Economics minor.

Since the article I wrote in August 2017 for *HFM's* East Coast Report, the value of Bitcoin has already increased another \$1,500 to north of \$5,500. There is so much buzz around the crypto asset space that we are approached and referred prospective clients a few times a week. Some of these new launches are funds who have tracked and traded cryptocurrencies for years, before it became the latest trend. Others are funds who have typically managed more traditional funds like long/short equity or commodities. In the interest in not missing out on some of the large returns these funds have generated, the long-time fund managers are now actively looking to launch crypto funds and compete for the capital being thrown at this investment strategy.

Theorem Fund Services has been approached by numerous crypto asset funds as of late to leverage our fund administration services. This asset class is here to stay and will not be going away anytime soon. Therefore, to dive further into this asset class, I consulted some of the service providers that have taken a strong expertise in this space and asked them many of the questions investors in the market have. I wanted to get a view from the many different service providers; legal, audit, and custody.

LEGAL

Q&A WITH BART MALLON OF COLE-FRIEMAN MALLON

Pat Mulhern (PM): What, if any, items in fund docs are unique to crypto funds?

Bart Mallon (BM): The fund offering documents, as a whole, are substantially similar to other fund vehicles with more "traditional" investment strategies. However, there are likely to be significant differences in the discussion of the investment programme, risk factors, and explanation of the custody of digital assets. Additionally, crypto funds typically have more limited liquidity provisions (lock-ups, side pockets and longer redemption cycles) and these items will be discussed in depth in the fund offering documents.

PM: How do you think the industry has evolved from a legal perspective from the beginning of crypto assets?

BM: We launched our first crypto fund over three years ago. At that time, we had to step back and figure out how this new "asset class" fit within the private fund legal and regulatory framework. We spent a good deal of time talking with the client and service providers to understand the

asset class. As part of this discovery process, we focused on a number of issues including custody of digital assets and whether these assets could be deemed to be securities. With respect to the latter issue, we believed that the normal *Howey* test would apply to each asset and SEC's recent release on Initial Coin Offerings (ICOs) confirmed that our analysis was correct.

PM: What are your future views on the space when it comes to regulation and the SEC?

BM: The biggest legal and regulatory issue for crypto fund managers moving forward will be how the SEC will deal with custody. Normally SEC registered investment managers must make sure that fund assets are held with a qualified custodian. In the crypto space, there are not any qualified custodians who offer comprehensive custody solutions. Some managers are also hesitant to trust custody of the assets to newer groups with relatively new experience with the asset class. We expect to hear more from the SEC on this issue in the first quarter of 2018 through regulatory guidance or through the no-action letter process.

CUSTODY

Q&A WITH TARA BOGARD OF KINGDOM TRUST

PM: How long has Kingdom Trust been involved in the crypto asset space and how far have you come since then?

Tara Bogard (TB): Kingdom is an industry leader in helping private funds and organisations meet custody rule requirements. We have been doing so since 2010, and now we are doing it for funds with digital assets. We have always made it a priority to provide flexible and innovative custody solutions. When the idea of digital currency arose a few years ago, we decided to dig in and see if we could work out a solution. Over the past few years we have done just that, and we are proud of the process and exceptional security solutions we have been able to implement.

PM: What would you say is the most challenging issue with custody for this asset class?

TB: A common pitfall we see at the moment, is the desire to actively trade within the account. In a perfect world, one would be able to have speed and security; however, we believe security is the main goal in regard to this asset class. Therefore, the solution we have built isn't as friendly for an active day trader. With that said, we are working every day



to expand our solution and create ways to meet the client's needs, while maintaining the security and integrity of the product.

PM: What makes a fund choose to use a custodian in this space given they are not required to?

TB: There are many firms who currently provide self-custody, as there are still a lot of grey areas in this arena. What I am seeing more of, however, are firms quickly moving away from this idea and over to a custodian. Not only do we bring custody rule compliance to the table, but also a solid, secure solution for the storage of digital currency. We have clients who aren't required to use a custodian, but choose to utilize us solely for the additional security it provides for the currency.

AUDIT

Q&A WITH STEPHEN VLASAK AT RICHEY MAY

PM: When did Richey May decide to develop an expertise in the crypto asset space?

Stephen Vlasak (SV): In the past six months, this has been the most active space within alternative investments by far. Our firm was very fortunate to get involved with digital currencies a few years ago, so our audit and tax teams understand the unique challenges they face.

PM: As an auditor, what are some of the key areas you focus on?

SV: From an audit perspective, the key areas we look at

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include existence of digital assets on exchanges or cold storage and valuation issues related to investments in ICOs that might require a side pocket. Depending on these responses, we tailor our audit approach accordingly. We also review and test the internal controls in place and work closely with the administrator to ensure everything is being implemented properly.

PM: How do you see the crypto asset space evolving in the future?

SV: Richey May sees the crypto space growing in a positive direction, with more groups such as custodians and other key service providers getting involved. In our opinion, it is only a matter of time before regulatory bodies start taking stronger positions and issuing more guidance on these types of investments.

CONCLUSION

To wrap up this topic, it should be a very interesting asset class to keep your eye on moving forward. Cryptocurrencies have grown tremendously in value as well as popularity. As a fund, you want to surround yourself with strong service providers who work well together for a seamless partnership.

Theorem Fund Services has had the opportunity to develop and get involved in many of these partnerships which is great to leverage each other's different views and expertise. It makes for an efficient, well rounded service for the clients. ■

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Chicago Board of Trade Building
141 West Jackson Boulevard
Suite 4120
Chicago
Illinois 60604

(312) 952-1455

sales@theoremfundservices.com
www.theoremfundservices.com