

PRIMER

Why institutions need a qualified custodian

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#LearnWithAnchorageDigital

The security standard for institutional custody

Qualified custodians provide the highest level of regulated security for crypto assets.

What is a qualified custodian?

Secure and regulated custody of digital assets

Following the enactment of the Investment Advisers Act of 1940, the U.S. Congress granted the U.S. Securities and Exchange Commission (SEC) oversight of the custody of an investment adviser's client accounts. Since then, policymakers have refined this oversight—notably in 2010 when the SEC made important changes to the "custody rule," enhancing requirements related to the use of "qualified custodians" by investment advisers.

The application of this designation to digital assets is a foundational concept to the safekeeping of institutionally held assets. A qualified custodian of digital assets has been granted legal authority by the SEC to provide regulated custody of cryptocurrency, where a custodian must definitively and transparently meet its regulator's guidelines for keeping institutional assets safe and secure.

Working to define a qualified custodian for crypto assets

Compliance with federal banking regulations

To be considered a qualified custodian of crypto, a financial services provider should meet regulators' compliance requirements for transparent safekeeping of assets. Federally chartered banks, which are under the purview of the U.S. Office of the Comptroller of the Currency (OCC), unambiguously meet this definition.



Qualified custodians should:

1. Implement a strong security infrastructure with a built-in dual-control system for movement of all fiduciary assets
2. Avoid putting client assets on their balance sheet to shield assets from the risk of bankruptcy
3. Enable client access to funds and continuous reporting on-chain

A qualified custodian can help secure digital assets

How could institutions be better served by working with a digital asset qualified custodian?



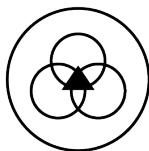
Unambiguous compliance

Transparent compliance with regulatory requirements that satisfies the custody rule of the Investment Advisers Act of 1940.



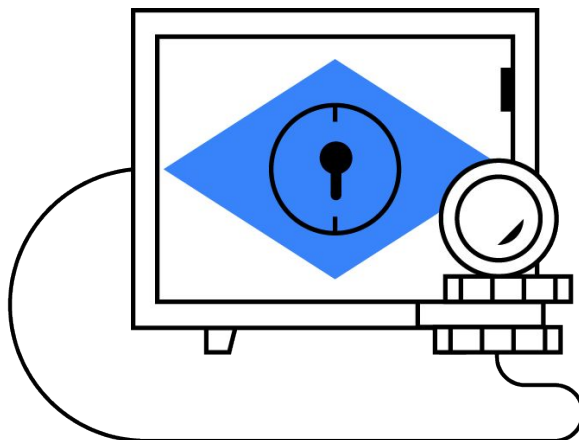
Bankruptcy protection

With a qualified custodian, client assets are not placed on the custodian's balance sheet and are not part of the debtor estate in the case of a bankruptcy proceeding.



Separate safekeeping of assets

Qualified custodians hold valuable assets for safekeeping in separate or segregated client accounts, whether tangible objects like gold or stock certificates, or intangible assets like crypto—these assets are not commingled.



Accounting of assets

Movement of assets must be accounted for in a transparent, auditable way, with regular audits and examinations performed by qualified independent accountants.



Secure custody

Variations in custody models and controls will affect the level of security each custodian can offer, therefore, institutions should perform their own risk assessments to fully safeguard assets from threats.

Best practices of digital asset qualified custodians

While the law is unambiguously clear that federally chartered banks under the purview of the OCC meet the definition of qualified custodian, it is not possible to make a blanket declaration as to whether other security providers like state trusts universally satisfy the client protection goals of the Custody Rule.

To determine whether or not an entity meets the definition of qualified custodian requires an evaluation of their technical capabilities, regulatory oversight, and fiduciary requirements.

Any institution looking to safeguard their digital assets should assess providers for the following technical capabilities:



Dual-control requirements

As required under 12 CFR 9, dual controls help to ensure executed transactions match customer instructions. These controls can be built into a qualified custodian's technology to require such controls for all movements of fiduciary assets.



Segregated accounts

Client custody assets are maintained in separate vaults, and client assets are not commingled with company assets.



Proof of exclusive control

A qualified custodian of digital assets must be able to prove exclusive control of private keys. Custodians that rely on redundancy (i.e. maintaining multiple or physical or electronic copies) and physical security cannot definitively demonstrate this.



Proof of existence

A qualified custodian should always be able to prove the existence of assets held under custody when requested as an essential client protection. Doing so validates that private keys exist, that the private keys are functional, and that they are held exclusively in the name of the right parties.



Hardware security

Although not a requirement to meet the definition of a qualified custodian, there are existing best practices in place when it comes to managing cryptographic data through the use of HSMs. HSMs, when paired with strong controls, meet goals of exclusive control, regular existence proofing, and are also auditable by clients and third-party vendors.

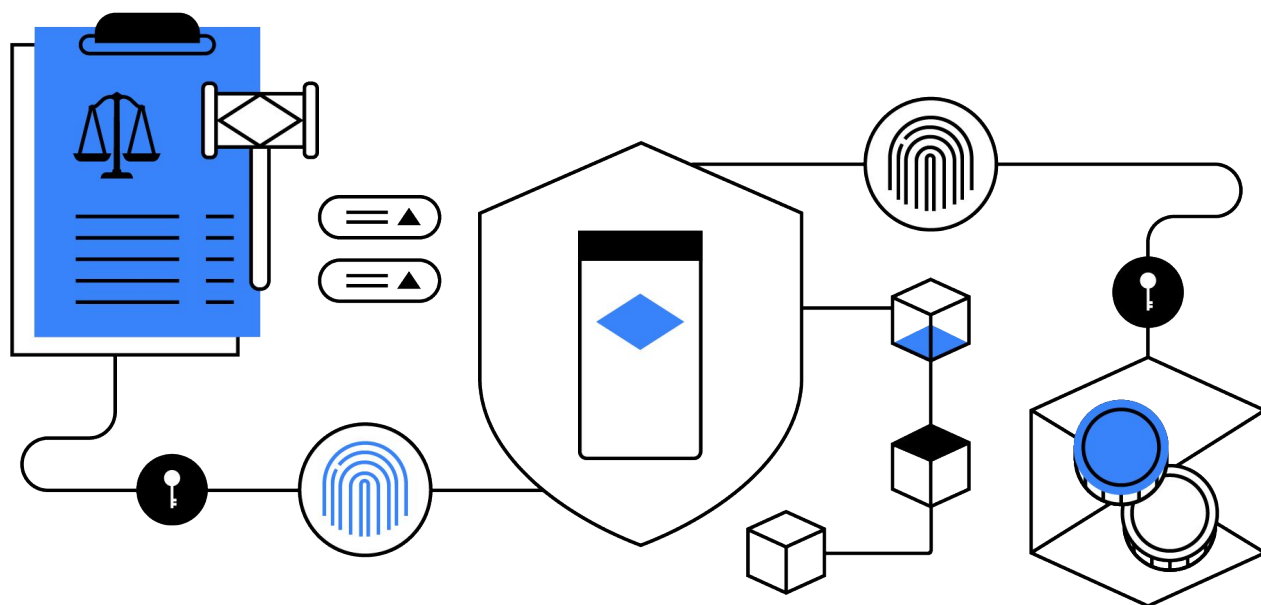


Blockchain monitoring

Institutions should work with a qualified custodian that implements clear policies and procedures for monitoring blockchain activity across all custodied digital assets on a regular basis. Though not a requirement, qualified custodians should prioritize assessing the unique security concerns and vulnerabilities to exploits inherent in digital assets.

Oversight and fiduciary requirements for federal banks

- 1. Risk-based approach to capital adequacy requirements:** A qualified custodian should assess a variety of potential risks and set capital adequacy requirements based on that assessment.
- 2. Financial and legal independence:** Operating in the best interest of clients, the market, and capital formation requires a qualified custodian to operate unencumbered by the legal or financial structure of a parent entity or affiliates.
- 3. Credible challenge:** To meet OCC requirements, for banks looking to be qualified custodians, board oversight needs to be independent and informed enough to be able to exert influence over the bank itself.
- 4. Consumer protection:** Federally chartered banks are required to protect consumer privacy information through adherence to the Gramm-Leach-Bliley Act (GLBA), and maintain a fiduciary audit committee to ensure fiduciary activities are independently reviewed and monitored.
- 5. Three lines of defense:** The OCC expects banks under its purview to maintain three lines of defense in order to protect against improper bank management and eliminate single points of failure: operations, compliance, and independent audit.
- 6. Federal oversight and fiduciary requirements:** The OCC has a number of structural requirements for fiduciary banks under its purview that may or may not be prioritized by state regulatory bodies.



Does your institution need a qualified custodian?

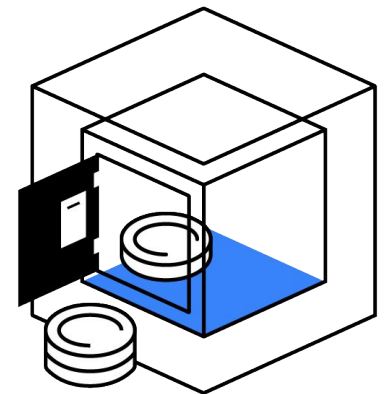
Your institution may need a qualified custodian to secure assets if you:

- ☐ Require your custodian and security provider to transparently meet federal regulatory requirements for the safekeeping of client assets
- ☐ Are a wealth manager acting on behalf of clients with custody of client funds, securities, or digital assets
- ☐ Serve wealth managers that must meet federal obligations
- ☐ Are a financial institution that requires unambiguous compliance across services
- ☐ Serve institutional clients who require confirmation that their assets held under custody would not be listed on your security partner's balance sheet and that their assets would be backstopped in the event of bankruptcy
- ☐ Require transparent and regular funds reporting for proof of asset existence
- ☐ Require separate accounts so that client assets are not commingled

Evaluating a qualified custodian

When evaluating your custodian, confirm that they:

- ☐ Are a federally chartered trust bank
- ☐ Keep client assets in separate accounts
- ☐ Provide direct connectivity to client assets on-chain
- ☐ Monitor the underlying blockchains of assets
- ☐ Have an adequate history of holding and servicing digital assets
- ☐ Have financial and legal independence from their parent entity and affiliates
- ☐ Operate under the concept of a "credible challenge" where board oversight is independent and informed enough to exert influence over the bank itself
- ☐ Provide consumer protection via the Gramm-Leach-Bliley Act (GLBA)
- ☐ Offer three lines of defense, including operations, compliance, and an independent audit function
- ☐ Meet all applicable requirements around auditing and internal controls
- ☐ Maintain a record of every transaction across all client accounts
- ☐ Offer the kind of reporting that investment advisers are required to have
- ☐ Offer a risk-based approach to capital adequacy requirements based on assessment of a wide range of potential risks



The first federally chartered digital asset bank

Anchorage Digital Bank is the first crypto-native bank to receive a charter from the OCC. As a qualified custodian, Anchorage Digital Bank works closely with its regulators to meet stringent compliance requirements and to set the industry bar for digital asset operations under federal oversight. From wealth managers to venture capital firms, clients using Anchorage Digital benefit from heightened operational, regulatory, compliance, audit, and governance controls.

Anchorage Digital APIs enable direct connectivity to assets on-chain. Assets are not commingled, and are secured in separate client accounts. Anchorage Digital is subject to the highest standards of federal financial regulation including Bank Secrecy Act (BSA), know your customer (KYC), anti-money laundering (AML), and stringent reporting and accounting practices.

Because Anchorage Digital mitigates vulnerabilities that expose private keys to risk, asset holders now have the option of a qualified custodian that's both more secure and usable, compared to other custody models on the market. Anchorage Digital custody does not use hot wallets or cold storage, and offers the benefits of secure trading, staking, governance, and other services.

Institutions trust Anchorage Digital for:

- Regulatory compliance as the first OCC-chartered crypto bank
- Direct connectivity to assets on-chain
- Unparalleled security with HSM private key management
- Industry-leading client service

About Anchorage Digital

Anchorage Digital is a global crypto platform that enables institutions to participate in digital assets through custody, staking, trading, governance, settlement, and the industry's leading security infrastructure. Home to Anchorage Digital Bank N.A., the first federally chartered crypto bank in the U.S., Anchorage Digital also serves institutions through Anchorage Digital Singapore, which is licensed by the Monetary Authority of Singapore; Anchorage Digital New York, which holds a BitLicense from the New York Department of Financial Services; and self-custody wallet Porto by Anchorage Digital. The company is funded by leading institutions including Andreessen Horowitz, GIC, Goldman Sachs, KKR, and Visa, with its Series D valuation over \$3 billion. Founded in 2017 in San Francisco, California, Anchorage Digital has offices in New York, New York; Porto, Portugal; Singapore; and Sioux Falls, South Dakota. Learn more at anchorage.com, on Twitter [@Anchorage](https://twitter.com/Anchorage) and on [LinkedIn](https://www.linkedin.com/company/anchorage-digital).

Custody, settlement, staking, and governance services are offered through Anchorage Digital Bank National Association ("Anchorage Digital Bank"). Digital asset trading services are provided by Anchorage Hold LLC ("Anchorage Hold"). A1 Ltd. is a principal trading business. Anchorage Services, LLC ("Anchorage Services") is an NFA-registered introducing broker, NFA ID No. 0532710. Anchorage Digital Bank, Anchorage Hold, and Anchorage Services are not registered with the SEC or any state authority as a broker or dealer and are not authorized to engage in the business of the offer, sale, or trading of securities. Anchorage Digital services are offered to institutions and certain high net worth individuals in limited circumstances, and are not marketed to residents outside of the US. Certain trading services are designed and available only for institutions who meet eligibility requirements, including qualification as an Eligible Contract Participant (ECP) under the rules of the U.S. Commodity Futures Trading Commission. For institutions participating in custody, staking, or governance with Anchorage's Singapore entity, those services are offered through Anchorage Digital Singapore Pte Ltd ("Anchorage Digital Singapore"). Anchorage Digital does not provide legal, tax, or investment advice or private banking services. Holdings of cryptocurrencies and other digital assets are speculative and involve a substantial degree of risk, including the risk of complete loss. There can be no assurance that any cryptocurrency, token, coin, or other crypto asset will be viable, liquid, or solvent. No Anchorage Digital communication is intended to imply that any digital asset services are low-risk or risk-free. Digital assets held in custody are not guaranteed by Anchorage Digital and are not subject to the insurance protections of the Federal Deposit Insurance Corporation (FDIC) or the Securities Investor Protection Corporation (SIPC).