anchorage digital

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Oversight & asset protection in crypto bank custody

EK2022

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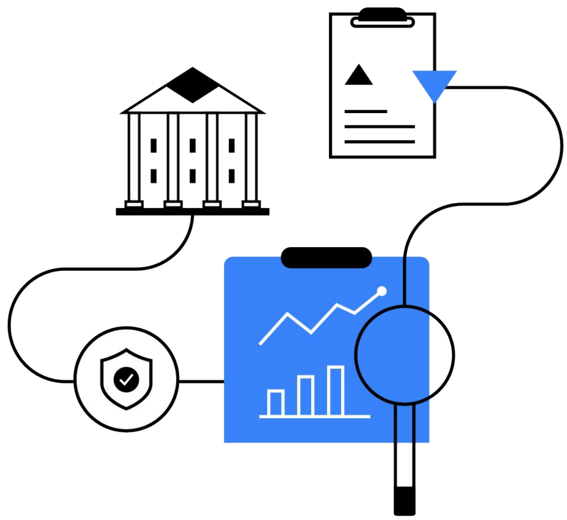
Oversight & asset protection in crypto bank custody

At a foundational level, trust banks implement a financial structure and security architecture to keep client assets safe. This approach is designed to shield assets from risk by keeping them bankruptcy remote. Trust banks do not put client assets on their balance sheet as they are not the beneficial owner of client securities. Instead, under generally accepted accounting principles, client assets are noted in the bank's financial statements as assets held in trust for the benefit of clients and do not become part of the bankruptcy estate if a trust bank fails. For a federally chartered crypto bank like Anchorage Digital, segregation of client accounts from the bank's accounts is a legal requirement and forms the basis for protections in bankruptcy.



Because client assets are never deemed assets of the bank, they do not become part of the debtor estate in a bankruptcy proceeding and are not subject to an automatic stay—creditors would not be able to pursue a claim on assets that clients have in custody with the bank. In a bankruptcy scenario for a federally chartered bank, the Office of the Comptroller of the Currency (OCC) would step in as receiver to distribute assets to the applicable clients. This means that clients are never considered general unsecured creditors and their assets would be protected.

Critical distinctions

Assets held under custody by trust banks are:

- Not placed on the custodian's balance sheet, and are not part of the debtor estate in the case of a bankruptcy proceeding
- Protected in the case of a custodian's insolvency whereby the bank's regulator will step in as receiver
- Held in trust for the benefit of clients, who are never considered general unsecured creditors
- Verified through record keeping as to ownership of assets; clients have a contract with the bank alongside legal protections

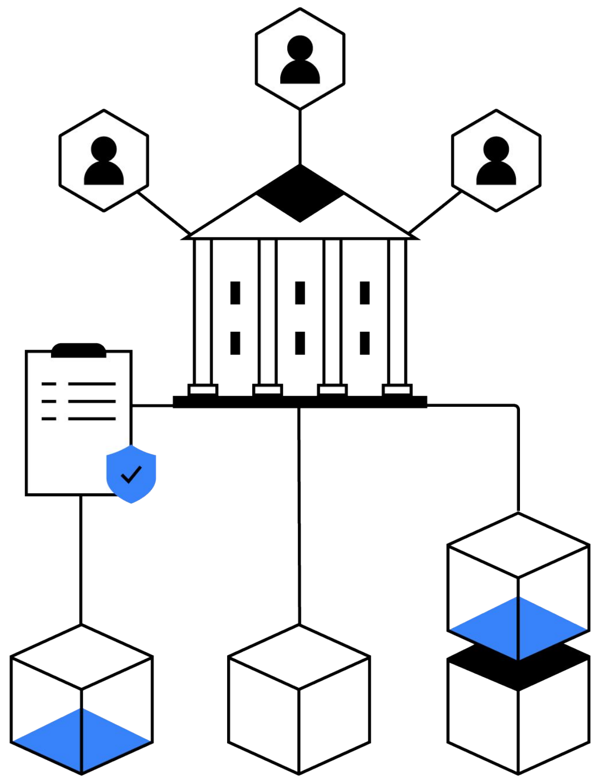
Oversight & asset protection in crypto bank custody

Oversight & controls for trust banks

Trust banks are subject to stringent controls including risk-based capital adequacy assessments and additional requirements that ensure that the bank can maintain financial resilience and be self-supporting through the sanctity of its charter.

Trust banks are also expected to have a high degree of corporate oversight, including an independent board of directors designed to hold management accountable, and lines of defense including regulatory compliance, internal audits, and third-party audits.

In addition, a trust bank may choose to implement operational practices that further ensure the safety of client assets such as maintenance of separate vaults per client rather than omnibus accounts.



Important differentiators

Trust banks are:

- Subject to regulatory oversight and must comply with regulatory standards
- Institutions that offer protection of client assets in the event of bankruptcy
- Required to provide risk- and loss-mitigating security architecture
- Regularly audited for controls including accounting practices and detailed client reporting

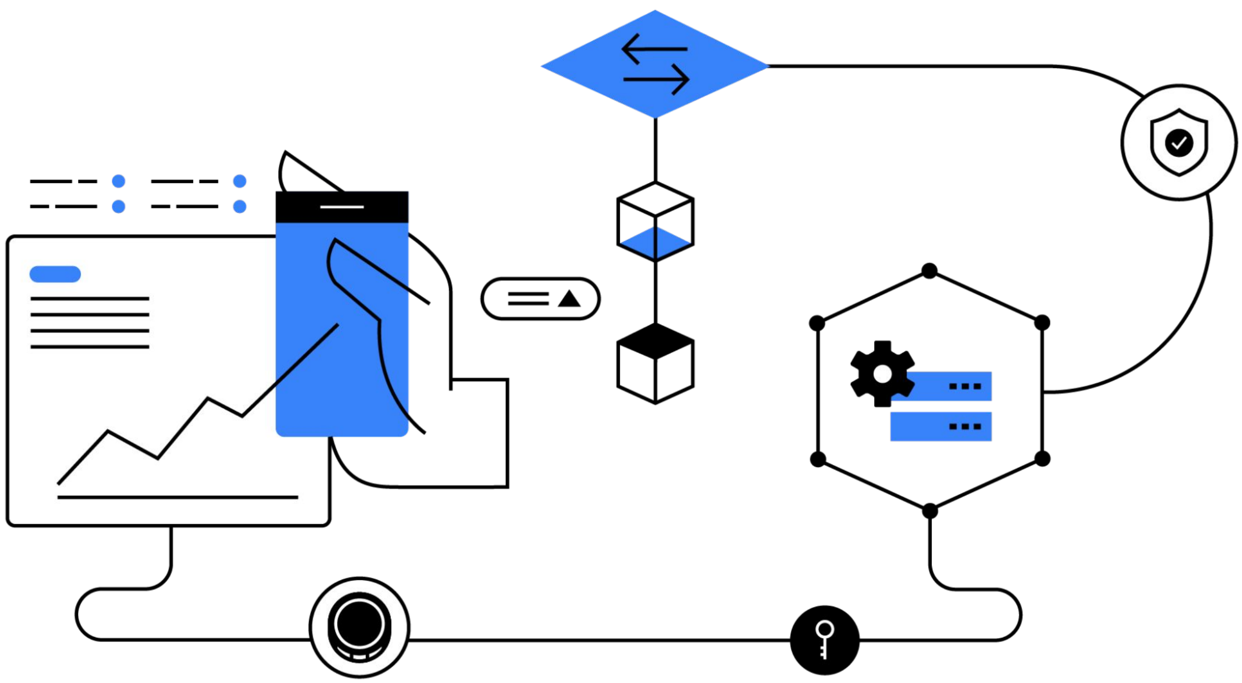
The risks of exchange custody

Institutions should beware that exchanges requiring digital asset custody—including those offering hot storage—introduce counterparty risk because the assets are not bankruptcy remote. Notably, the status of how assets will be treated becomes uncertain in a bankruptcy situation.

Many of the cornerstones of trust bank custody are absent in the case of exchange custody. Specifically, lines of defense such as operations, compliance, and audits are not required, and no regulator will step in as receiver in the event of bankruptcy. Client assets could be commingled with the exchange's assets and are at risk of being considered part of the debtor estate in a bankruptcy proceeding. As a result, clients could be considered general unsecured creditors.

Privacy considerations must also be taken into account by institutions looking to custody assets with an exchange. Although privacy is protected by the Gramm-Leach-Bliley Act (GLBA) when assets are held by a trust bank, this is not necessarily the case with exchange custody.

Additionally, risk-based capital adequacy assessments are not required to be regularly conducted for exchanges. Therefore, transparency around insolvency risk is less clear for exchange clients.



Crypto oversight and asset protection: trust bank custody vs. non-bank custody

	Trust bank custody	Non-bank custody
Independent of parent company and affiliates	Yes	Maybe
Independent board members	Yes	Maybe
Required to have fiduciary audit committee report directly to the board	Yes	No
Subject to staffing assessments as part of supervision and oversight	Yes	No
Required to have a dedicated compliance team	Yes	Maybe
Required to protect consumer privacy information by adhering to the Gramm-Leach-Bliley Act (GLBA) or other standards	Yes	No
Subject to risk-based capital adequacy assessments	Yes	No
Lines of defense include operations, compliance, and audits	Yes	No
Must meet Bank Secrecy Act (BSA) requirements	Yes	Maybe
Regulator steps in as receiver in the case of bankruptcy	Yes	No
Assets are not commingled with company assets	Yes	Maybe
Assets are bankruptcy remote and not part of a debtor estate in bankruptcy proceedings	Yes	No

About Anchorage Digital

Anchorage Digital is a regulated crypto platform that provides institutions with integrated financial services and infrastructure solutions. With the only federally chartered crypto bank in the US, as well as Anchorage Digital Singapore, which offers equivalent security and service standards, Anchorage Digital provides institutions an unparalleled combination of secure custody, regulatory compliance, product breadth, and client service. Founded in 2017, Anchorage Digital is valued at over $3 billion with funding from leading institutions including Andreessen Horowitz, GIC—Singapore's sovereign wealth fund, Goldman Sachs, KKR, and Visa. Headquartered in San Francisco, California, Anchorage Digital is remote-friendly with offices in New York, New York; Porto, Portugal; Singapore; and Sioux Falls, South Dakota. Learn more at anchorage.com, on Twitter @Anchorage and on LinkedIn.