

The Institutional Requisites of a Justifiable Digital Assets Custody Global Landscape

The increasing interest in digital assets from both retail and institutional investors has given rise to the growth of many custody options provided by different players, applying varying approaches and strategies especially in areas relating to keeping the assets safe.

To define how the products and solutions operate, it will take some time before it reaches an equilibrium where a common approach of digital assets and their custody will emerge through mutual collaborations among the regulators, providers and end-clients. Various types of custody options have emerged as the market evolves, and they can be broadly categorised into two types: Retail Custody Solution and Institution Custody Solution.

The digital assets custody solutions were first created for retail crypto market due to the strong demand from retail investors. As the crypto market began to mature and with better clarity on financial regulations, there was a corresponding increase of institutional interest in crypto. This has given rise to the growth of custody options from new providers that are seeking to establish the structures and controls that work best for institutions.



What is Institution Digital Assets Custody?

Ultimate Beneficial Owner

The definition of Ultimate Beneficial Owner (UBO) is an individual that benefits from or is impacted positively from a company even though they are not formally named as the owner of a business. In the case of retail customer, he or she is the UBO and also the manager of the funds. The retail investor purchases cryptocurrencies for his or her own personal account and store them in retail custody wallet solution.

Conversely, for institutional customers that come from different company types, there is a clear distinction between the UBO and the manager of the assets. For example, if it is a corporate or fund, the corporate shareholders or fund investors are the UBOs, whereas the officers of the company or the fund managers are the managers of the assets, respectively. Independent third-party custody becomes really important when there is a distinction between UBOs and managers as it is necessary that the interests of all the parties are kept aligned at all times.

Unique and Bespoke Solution

Each institution has its own unique and different requirements for their digital assets custody solution because of the varying company sizes, complex structure with globally distributed processes as well as the myriad of institutional types such as banks, payment services providers, trading platforms, family offices, corporates or funds.

A successful institutional digital assets custody provider therefore must have the ability to create bespoke solution that serves the specific need of each institution. A one-size-fits-all solution will not work as it assumes that all institutions have the same requirements. Additionally, the provider must be able to integrate the custody solution with other services provided by the institutions such as cash, foreign exchange (FX), and their internal systems, among many others.

Granularity of Governance

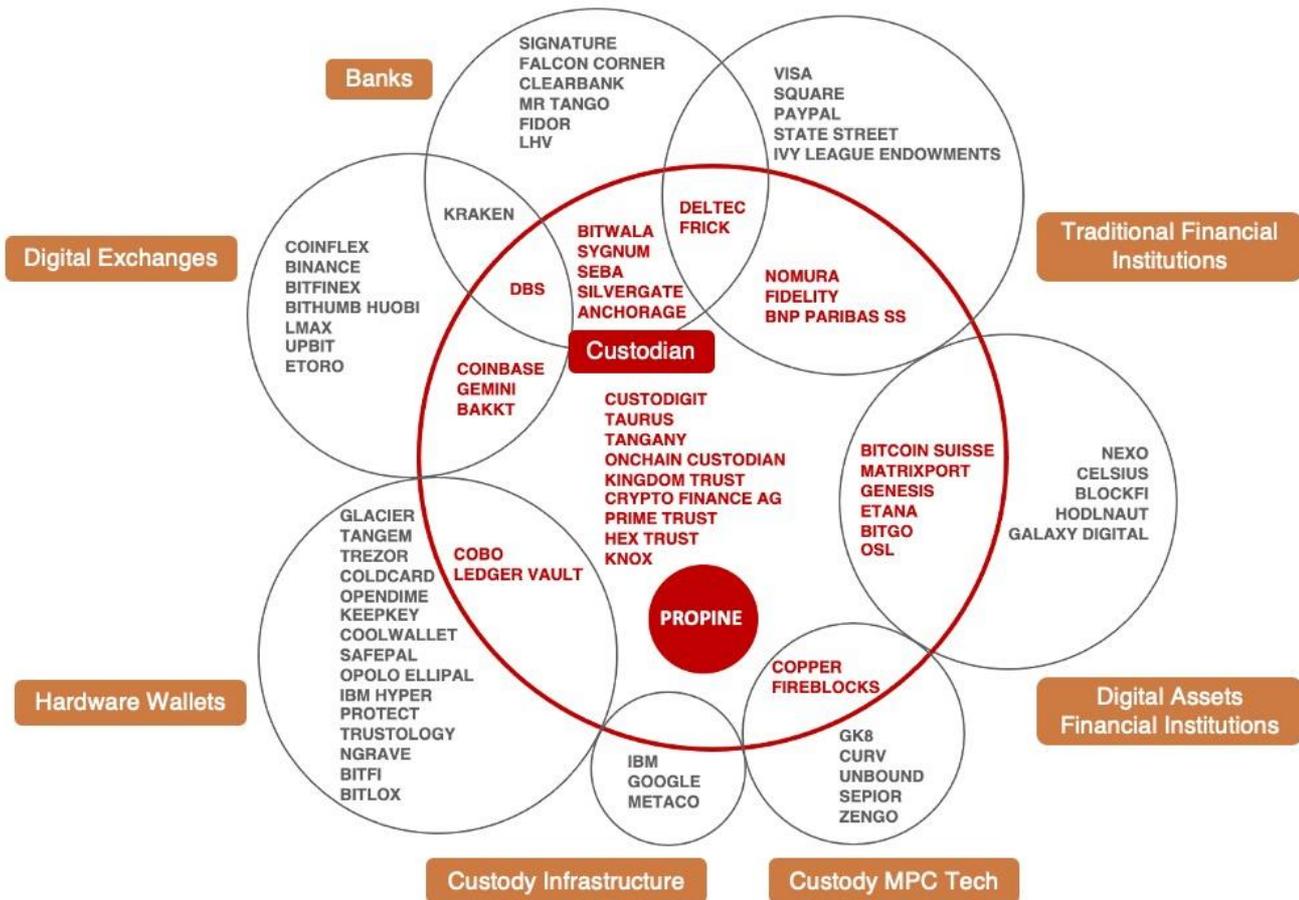
Other important considerations for institutional digital assets custody are the regulatory, operational and risk control functions such as ownership verification, investment of funds in line with the needs of the fund managers, risk limit monitoring etc. Granular governance is hallmark of an institutional solution. In such solutions, the set up and management of authorization, transaction, supervisory, compliance and operational control policies to suit specific industry or institution's needs is easily managed, unlike much simpler, one-size-fits-all retail custody solutions.

Global Landscape of Digital Assets Custodian

Digital assets custodians play a vital role in facilitating asset security while ensuring ease of transaction through the financial system. Compliant custodian solutions are the basic infrastructure and a precondition for a mature and thriving crypto industry. The motivation behind lies in its offering of capital inflow channel secured by multi-party trust through blockchain technology and the safeguarding of crypto assets.

And it is with these presumptions, many players including both traditional institutions and FinTechs, are venturing into the space of digital assets custody. Currently there is already a handful of players that are providing digital assets custody solutions, but who are those FinTechs and traditional incumbents exactly and how is this landscape emerging?

LANDSCAPE FOR DIGITAL ASSETS CUSTODIANS



** Propine is the ONLY digital assets custody provider that is regulated by MAS and has a Capital Market Services licence*

Traditional Market Movement

The traditional players have certainly made huge progress in this space especially in recent times.

Fidelity began offering bitcoin custody services in March 2019 through a separate subsidiary called Fidelity Digital Assets while in the following month, BNY Mellon partnered with crypto exchange, Bakkt who has earlier acquired Digital Asset Custody Company (DACC), to help it to launch a custody service.

In June last year, Japan's biggest brokerage and investment bank, Nomura, has launched its Komainu, a cryptocurrency custody service for institutions in partnership with Blockchain security firm Ledger and the fund manager CoinShares, that is regulated by the Jersey Financial Services Commission.

Last December, DBS became the first traditional bank in the region in Asia to offer crypto exchange and custodial solutions to institutional clients and most recently, PayPal has just announced that they will acquire cryptocurrency security firm Curv as part of its push into digital tokens.

Types of digital assets custody providers

Hardware Wallets

While self-custody including self-managed hardware wallet is essentially a non-starter for institutional investors due to regulations and the legal obligations that define their fiduciary responsibilities, there are still many FinTechs that provide self-custody solutions include Cobo, NGrave and Ledger Vault, especially catering to the needs of the retail market.

Digital Exchanges

On the other hand, digital assets exchanges, more than often provide digital asset custody service as a value-added service so as to elevate their clients' experience through a convenient, seamless and ease of usage platform.

However, this form of custody also poses a greater risk from a stronger tendency of attack from hackers, as observed in the past that resulted in hundreds of millions of dollars of losses. Under such a custodial arrangement, the cryptocurrency owner does not possess the private key of the wallet. Some typical examples of digital exchanges that provide crypto custody service as part of their incidental service include Binance and Coinbase.

For digital exchanges to be compliant and secure, a good legal framework must be established with broker dealers involved in a trade, digital asset custodian and the end investor. As such, they must have a clear identification of customer assets held in custody separate from those of the custodian or the exchange.

This is to ensure that there is a legal protection provided under court of law to protect the interests of the investors such that their assets are kept aside and do not get attached to the balance sheet of the service providers, in an unlikely situation that the exchange or custody player goes into liquidation.

To reduce the regulatory risks faced by exchanges and investors, the digital assets custody provider must be licensed and able to demonstrate strong framework to adhere to regulatory compliance for the emerging token economy.

Custody MPC Tech

Digital Asset custody providers, using multi-party computation (MPC) protocols that eliminate the concept of private keys, and thereby replacing the need for both cold and hot wallets are quite the new kids on the block and therefore are still not battle-tested. Nevertheless, FinTechs such as Copper and Fireblocks are valuable addition to the arsenal of security solutions and will possibly need to live through a few years in the market to ensure a robust end-to-end security solution to protect critical digital assets for their clients.

Digital Assets Financial Institutions

The digital assets financial institutions such as Bitcoin Suisse and Genesis are financial intermediaries that offer a suite of services besides digital assets custody, including prime brokerage, trading, loans, staking and other crypto-financial services for private and institutional clients.

Digital Asset Custody Specialists

At the core, the digital assets custody specialists are divided into two categories: the non-regulated FinTechs that include Custodigit, Taurus, Onchain Custodian, etc. and the regulated limited liability trust companies that provide custody and trade execution services for digital assets such as Kingdom Trust, Prime Trust and Hex Trust.

Propine is the first and only independent regulated digital asset custody provider that has been awarded the Capital Market Services licence. Through our robust institutional-grade custody solution to safeguard digital assets, Propine is able to resolve the gap for a regulated digital stack that can manage both security and non-security tokens using a single integrated platform.

Investors will be comfortable with holding their assets with an independently regulated custodian like Propine while digital assets exchanges are benefitted by Propine's technological architecture, which is agile, chain neutral, and integrated.

Moving forward

The global landscape of digital assets custody solutions aimed at keeping digital assets safe have continued to develop since the invention of cryptocurrency. It is evident that there is an increasing global demand for suitable custodial options to help manage the use of digital asset and facilitate its growth and adoption.

From FinTechs to traditional financial incumbents, many began from different starting points and were solving unique custody challenges along the way, be it for the retail or institutional needs. Increasingly, it has been observed that the multiple paths taken by the different players in working towards the creation of specialised digital assets custody solutions have started to merge.

To achieve the envisioned critical mass adoption of digital assets especially among the institutional players, significant imperatives should be prioritised in safekeeping their assets. These include greater clarity in global regulations and provision of bespoke and regulated crypto custody solution that can enable granularity of governance.

Deciding which solution best addresses unique digital assets challenges must first start with the problem being clearly identified. A clear understanding on the custodial requirements is key in finding what works best, so that ultimately, it will lead to the discovery and adoption of a solution that fits the niche, perfectly.