Self Custody vs Institutional Custody

Self-custody is an important (and fundamentally native) feature of crypto currency. A blockchain-based digital asset can be stored by its owner without the help of traditional financial intermediaries, such as banks, registered brokers/dealers or qualified custodians. But just because you can store all your coins yourself, should you?

The answer depends on many factors, for example, the variety of currencies, the frequency of transfer and the complexities and risks of self-custody which commensurate with the size of funds being stored. Moreover, your custody solution will differ depending on whether you are a typical consumer, a high net worth individual, or an asset manager.

While most consumers will often prefer the self-custody option, some will likely keep their deposits in hosted exchanges or hardware wallets. Crypto currency custody is more difficult to implement for investment managers due to the regulatory nature of their operations, funds require stringent custody methods that address risks such as security of the digital assets, counterparty risk and operational efficiency that comply with requirements of their regulator. Typically, these funds work with qualified custodians with audited control processes who exist to protect these assets and minimize the risk of their theft or loss, whether these are assets in physical or electronic forms.

From a technology perspective, blockchain technology can transform the role of the qualified custodian at many levels:

- High levels of security can be achieved via strong encryption
- Verification of funds can be granted to white-listed Auditors and Administrators
- The proof of existence and control element of a fund audit can be accomplished quickly and in real-time
- Digital assets can be quickly transferred to a broker, exchange, or dealer
- Specific compliance rules can be embedded in smart contracts or via secure multi-signature rules

In an ideal world, everyone could practice self-custodianship while providing auditors and regulators the required transparency, protection and proofs. Custody of crypto assets presents a high barrier to entry into the crypto market for institutional players. While self-custody is the preferred method for individuals, institutional money needs institutional level custody, but it's not yet clear what the best solution is. As new players (hedge funds, VCs, exchange-traded funds, mutual funds, asset managers) are entering the market, many are seeking out third party custodians rather than opting for self-custody.

The third-party custody market is relatively new and evolving quickly. Third-party custodians looking to offer custody for institutions are still in the process of developing their products and services, while institutions seeking third party custodians are still figuring out what features they need, and how to evaluate the advantages and disadvantages of these solutions, when compared to self-custody.

When researching third-party custodians, one should consider key features such as:

- Jurisdiction — Politically stable jurisdiction with a long history of recognizing the rights of ownership

- Size of the organization i.e. number of employees, clients and assets under custody
- Experience of the team operating the custody solution
- Regulatory status and Compliance– are they regulated?
- Customer Support — Easily accessible 24/7?
- Level of security — e.g. 2FA/Multi-sig.
- Disaster recovery scenarios
- Private key ownership/exclusivity
- Crypto currencies offered
- Minimum amounts required for custody/transactions
- Pooling or segregation of digital assets
- Configurability of process and custom workflows for transfers
- Assessment of onboarding, setup, safekeeping, recovery and security procedures
- Costs
- Liquidity: how long does it take to get access to your funds and/or make a transaction?
- Insurance policy to cover for eventual theft

As well as completing a due diligence questionnaire covering all the relevant areas, the work of our operations team includes meeting with the custodians, reviewing control reports, following up with reference calls and continuously monitoring the financial health of selected custodians.