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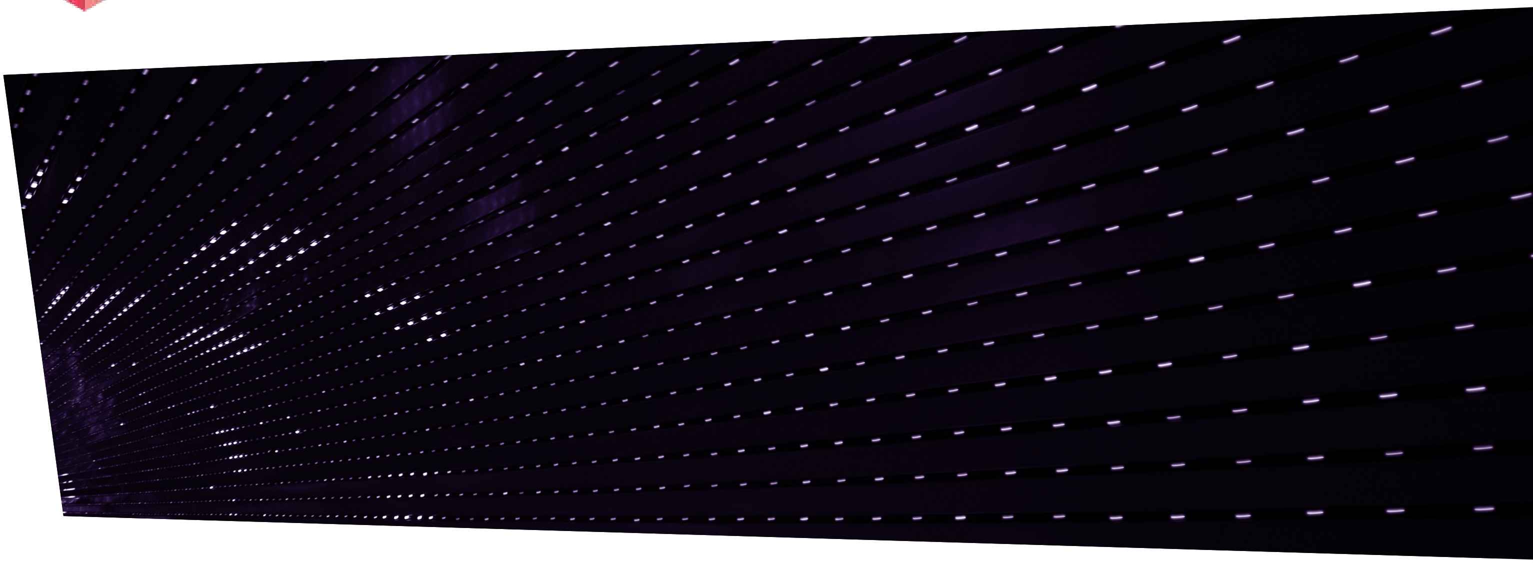

ARTICLE

Future of Crypto Market Infrastructure: The Role of Custodians and Exchanges

While bitcoin offers the possibility of removing third parties and making transactions peer-to-peer, the reality is that most cryptocurrency today is bought and stored using third party exchanges. These platforms typically act as combined brokers and custodians—executing orders on behalf of customers, and storing their funds in commingled omnibus custodial accounts. The fact is, crypto exchanges and custodians must evolve to become financial services institutions following robust regulatory frameworks and accountability practises if we want to see further institutional adoption.

OVERVIEW

Over the last decade, the liquidity flowing into cryptocurrency has been captured by various different exchange-custodians, creating a landscape of fragmented liquidity that is difficult for traders to navigate. At the same time, the growth-focused mindset of early exchanges has led to poor standards of security and regulatory compliance, creating billions of dollars worth of losses from hacks and security breaches. This insecurity has deterred large investors and institutional players from entering the market, further exacerbating the liquidity problem.

Even cautious smaller investors are often unwilling to be exposed to such high levels of counterparty risk, especially with an asset class that has irreversible transactions, where theft of private keys leads to permanent loss.

To improve this insecure and illiquid trading environment, the cryptocurrency ecosystem is beginning to mirror the institutions of traditional finance, with independent brokers, exchanges, and qualified custodians working together to provide secure custody and trading.

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Under the Investment Advisers Act of 1940, this custodial setup is a legal necessity for institutions with $150 million or more in assets. But it can also be beneficial to individual investors that want to mitigate counterparty risk. And in the bigger picture, this traditional division between custodians and brokers can help solve the broader liquidity, security, and user-experience issues that are preventing the market from scaling.

> "Protection of customer funds is paramount. Without trust, high quality service and real-time access to funds, the crypto sector will fail to expand past the current market cap and attract further adoption."
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By focusing solely on safeguarding private keys, specialised custodians can offer all the same assurances as traditional finance. Investors can avoid the complexity of setting up their own crypto wallets, and renegotiate the tradeoff between security and accessibility that typically accompanies the decision between storing crypto assets in hot or cold wallets, or on an exchange.

Crypto assets held with a trusted custodian can be both secure and accessible, with private keys stored in segregated accounts that are backed by insurance coverage, bank-grade security, full regulatory compliance, and governance controls over managed assets. These protections shield investors from the risks and complexity of the crypto market, creating the ideal starting point to make the most of the latest crypto asset innovations.

SAFEGUARDING CRYPTOASSETS - THE EVOLVING ECOSYSTEM

Instead of needing to visit different venues to access the financial services of trading, investment, and lending, each with their own specific onboarding requirements, investors using the services of a cryptocurrency custodian can easily access these different services from a single secure wallet.

Through decentralised finance (DeFi), brokers and exchanges can now access liquidity on decentralised platforms to better service their clients offering them more opportunities than ever to participate in the ecosystem and 'sweat assets' to maximise returns. This might be through lending, staking, borrowing, securing the network, or conducting complex trades with new financial instruments. Equally, brokers become best placed to introduce their clients to custodians featured in their network as part of their risk management strategy.

By offering investors the opportunity to tap into this ecosystem and generate an income without increasing security risks, crypto custodians move beyond basic safekeeping to become a one-stop shop for cryptocurrency services—a financial browser so to speak that partners with defi protocols and exchanges to offer secure, direct access to the same diverse range of liquidity lending and leverage services as prime brokers offer hedge funds in the world of traditional finance.

DIVERSIFICATION WITH DEFI AND STAKING

The rapid evolution of the cryptocurrency market has created more opportunities than ever for portfolio diversification, with smart contracts not just replicating the functions of traditional finance on the blockchain, but supercharging them—giving investors unique opportunities to take advantage of crypto assets.

The rise of Proof-of-Stake, which is expected to come to Ethereum later this year, is now giving investors the opportunity to be rewarded by setting aside assets to be "staked" or "delegated" in order to help secure the network.

From an investment perspective, income generated from staking is akin to earning interest on fiat in a bank account. But with staking, returns are typically far more lucrative. Ethereum 2.0 is expected to offer staking rewards up to 15%, and smaller chains like Cosmos are already offering 8%. This opportunity to earn a yield by staking has led to comparisons between Proof-of-Stake cryptocurrencies, and traditional assets like treasury bonds, which typically occupy a valuable position in an investment portfolio by offsetting risk.

Individuals choosing to stake independently however, take on the risk of incurring network penalties known as slashing. The economic model of Proof-of-Stake relies on a carrot and stick system, where honest validators that follow the rules of the network are rewarded, and misbehaving or lazy validators are penalised with a loss of tokens. While some bad actors might break the rules deliberately slashing penalties are equally likely to be incurred due to technical errors stemming from a non-professional supported staking set up.

Instead, stakers can focus on getting the best rates by choosing between different staking service providers offered through the exchange-custodian partnership.

> "With an independent custodian and exchange partnering to offer dedicated staking services and custody, investors can remove the risk of slashing by outsourcing the responsibility for following the staking procedure correctly."
>
> **- Trustology**

Aside from staking, custodians can also offer crypto investors secure access to the open-source system of smart contracts known as DeFi. This new form of financial plumbing gives traders access to shared liquidity pools, borrowing and lending protocols, innovative derivatives, and

decentralised peer-to-peer token exchanges — providing more potential than ever to maximise returns, minimise risk, and implement sophisticated trading and investment strategies.

REGULATED EXCHANGE + INSURED CRYPTO CUSTODIAN

As visionaries like Ethereum founder Vitalik Buterin have suggested, the ideal form of crypto custody infrastructure would let users securely tap into decentralised protocols and exchanges from a centralised fiat gateway Hence, what the browser is to the Internet and what the bank is to traditional finance is what the custodial wallet then becomes to the blockchain, and to the future of finance - an unbundled set of services accessed via an aggregator platform such as a wallet where users secure their keys in their wallets, and then use them to manage their assets.

With such a setup, an investor might sign into their custodial wallet to get full access to centralised or decentralised exchanges and protocols providing services spanning trading, lending, borrowing, staking, and liquidity — just like a prime broker might offer hedge funds bundled services in the world of traditional finance.

This secure access to financial innovation can be made possible through partnerships.

Independent custodians would remain responsible for safeguarding crypto assets with the same institutional-grade security mechanisms as traditional financial institutions, including segregated accounts and insurance coverage. These custodians could evolve to become 'smart custody platforms' or programmable custodians where endorsement APIs could effectively let end users move faster on opportunities in the market by enabling them to self-create controls or rules without needing to wait on the custodian to approve their business logic. They would also provide the technical infrastructure and support needed to integrate with staking services, DeFi protocols, and regulated fiat-to-crypto trading, through open APIs.

Exchanges meanwhile, can forge their own relationships with regulated banking partners to offer the seamless transfer of fiat into the system, and move beyond simple trading services by offering direct access to DeFi and staking — underpinned by the infrastructure of the custodian.

In light of these potential benefits, crypto custodian Trustology is exploring a partnership with soon-to-be regulated cryptocurrency exchange and client, coinpass.com.

Trustology's custodial infrastructure secures crypto assets with biometrics, multi-sig, top-tier encryption, walled gardens. Funds are covered by a range of insurance plans, and customer support is available around the clock. With advanced integrations, crypto asset holders are able to directly tap into the latest income opportunities — including staking on Ethereum 2.0 — in a safe, secure, and regulatory compliant manner, and securely access the DeFi economy from a web browser or mobile app via MetaMask integration or API integration.

Trustology continues to focus on building out solutions within its infrastructure that best deliver on best execution for clients and meet with institutional regulatory requirements around segregation of duties. Their goal is to lead with a flexible custodial platform that can easily integrate with the right services, protocols and partners to deliver on what's best and needed for its clients to reduce custody risk and overall transaction costs. They are currently exploring best practice in facilitating settlement and clearing, enhancing the treasury management workflow and incorporating more payment on ramp platforms such as coinpass.

Meanwhile, coinpass is forming the ideal entrance point into the world of DeFi — letting users swap pounds or euros for crypto with regulated banking partners, and then dive straight into the innovation of decentralised protocols. Their vision - a digital finance platform integrating banking, crypto and defi services for retail and institutional clients across multiple user interfaces. Having recently launched their mobile app trading platform, they are now turning their focus on banking DeFi services.

Together, this combined exchange - custodian partnership could bridge the gap between the institutions of traditional finance, and the burgeoning cryptocurrency ecosystem—preserving the security and compliance benefits of the traditional broker and exchange duo, while also delivering access to the new opportunities provided by digital assets.

ABOUT COINPASS

Award-winning UK based Cryptocurrency Trading Platform and Fiat on and off-ramp.

Visit **coinpass.com**

ABOUT TRUSTOLOGY

Insured, institutional crypto custodian safeguarding cryptoassets on-chain, on-exchange and across DeFi protocols with no compromise to speed, security or access.

Visit **trustology.io/business-accounts/**