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April 13, 2021

Submitted electronically via IMOCC@sec.gov

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC, 20549-1090

Re: Custody Rule and Digital Assets

Dear Ms. Countryman,

Anchorage Digital Bank National Association appreciates the opportunity to offer comment to the Securities and Exchange Commission ("SEC") on the definition of "qualified custodian" under rule 206(4)-2 of the Investment Advisers Act of 1940 (the "Custody Rule").

On November 9, 2020, the Staff of the Securities and Exchange Commission's Division of Investment Management (the "Staff") published a statement, in consultation with FinHub Staff, in response to a No-Action Letter issued by the Wyoming Division of Banking on October 23, 2020. In the statement, the Staff noted that the Wyoming Division of Banking letter "seeks to provide interpretive guidance on a critical component of the Custody Rule, the definition of a 'qualified custodian.'" The staff went on to request comment on certain questions relating to the custody of digital assets which we address below.

Anchorage Digital Bank National Association is a federally-chartered trust bank, regulated by the United States Office of the Comptroller of the Currency (the "OCC"). We are a member of the Federal Reserve and have full fiduciary powers under 12 CFR 9 and pursuant to our Approval Letter from the OCC. We provide digital asset custody and related services to institutional clients. However, we were not always a federally regulated bank. Prior to our conversion on January 19, 2021, we were operating as a South Dakota chartered Trust Company since July 12, 2019. As the only federally-chartered digital asset bank currently operating, the only digital asset custodian that has operated under both State and Federal regulatory oversight, and the only digital asset custodian to successfully complete a state-to-federal charter conversion, we bring a unique perspective to this conversation. Due to our experience and

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circumstances, we hope that our responses may provide valuable insight to the staff on questions relating to digital asset custody in general, and specifically to the matters addressed in the statement.

Prior to addressing the questions in turn, we would like to set forth the requirements of Rule 206(4)-2 of the Investment Advisers Act of 1940 (the "Act") also known as the Custody Rule. Pursuant to the Custody Rule an Investment Advisor must in most cases utilize the services of a qualified custodian to hold customer funds and assets. A qualified custodian is defined as:

(i) A **bank** as defined in section 202(a)(2) of the Advisers Act (15 U.S.C. 80b-2(a)(2)) or a savings association as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)) that has deposits insured by the Federal Deposit Insurance Corporation under the Federal Deposit Insurance Act (12 U.S.C. 1811);

(ii) A broker-dealer registered under section 15(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)(1)), holding the client assets in customer accounts;

(iii) A futures commission merchant registered under section 4f(a) of the Commodity Exchange Act (7 U.S.C. 6f(a)), holding the client assets in customer accounts, but only with respect to clients' funds and security futures, or other securities incidental to transactions in contracts for the purchase or sale of a commodity for future delivery and options thereon; and

(iv) A foreign financial institution that customarily holds financial assets for its customers, provided that the foreign financial institution keeps the advisory clients' assets in customer accounts segregated from its proprietary assets.

A **bank** is further defined as:

(A) a banking institution organized under the laws of the United States or a Federal savings association, as defined in section 1462(5) of title 12, (B) a member bank of the Federal Reserve System, (C) any other banking institution, savings association, as defined in section 1462(4) of title 12, or *trust company, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency, and which is supervised and examined by State or Federal authority having supervision over banks or savings associations,* and which is not operated for the purpose of evading the provisions of this subchapter, and

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(D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph. (emphasis added)

While it is clear that a banking institution organized under the laws of the United States or a Federal savings association, as defined in section 1462(5) of title 12 or that is a member of the Federal Reserve meets the above definition, to determine whether a trust company exercises fiduciary powers similar to those permitted to national banks is a facts and circumstances determination and relies on an analysis of both the chartering state's statute and the actual activities of the trust. Regardless, the point we would like to make is that once such analysis is concluded with affirmative results it is not dispositive.

In addition to determining if the above definitions are met, the Investment Advisor must evaluate the operations of such qualified custodian on a go forward basis in order to meet its fiduciary obligations to its clients. Therefore, while selecting a custodian that meets the black letter definition of a qualified custodian provided in the Custody Rule is required, it is not sufficient to fulfill an Investment Advisor's obligations under the Act.

Due to the fiduciary nature of an Investment Advisor and informed by the penumbra of the additional requirements with respect to determining a qualified custodian set forth in the Act, the Investment advisor cannot blindly direct funds to a custodian without conducting its own diligence and ensuring that such custodian is equipped to hold a particular type of asset. This is why we agree with the Staff's request for comment on these matters. We feel the issue is broader than the type of entity in question, and should also take into consideration the type and amount of oversight an entity receives, the underlying policies, procedures, and technical infrastructure an entity has in place, and an entity's ability to adequately perform the unique technological functions required to securely custody digital assets.

As the first and only federally chartered digital asset bank currently operating, Anchorage Digital Bank NA unambiguously meets the definition of qualified custodian under the Custody Rule. As such, we feel it is important to highlight the technical capabilities, architecture, infrastructure, and level of oversight needed to meet the definition of qualified custodian in the digital asset space.

Before we do, we would like to point to some recent comments made in regards to the mission of the SEC. On February 22, 2021, in a talk at George Washington University Law School's conference on regulating the digital economy, SEC Commissioner Hester Peirce opined on the role of the SEC specifically and regulators more generally by saying the "role is to protect investors and markets, not incumbents."[1] As we parse out what it means to be a qualified custodian of digital assets, what fiduciary

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[1] https://www.sec.gov/news/speech/peirce-atomic-trading-2021-02-22

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responsibility means in the digital asset space, and which qualities unique to digital assets should be considered important to their safekeeping, it's important to keep that mission—both what it is and what it isn't—front of mind, particularly as it relates to incumbency.

In many ways, the evolution of cryptocurrency as an asset class has its roots in addressing perceived shortcomings of an incumbent class of institutions, structurally and otherwise. Arguments for categorical inclusion in the grouping of institutions equipped and permitted to custody and otherwise service a fundamentally new class of assets based on incumbency, or the technological capability to custody qualitatively different asset classes, put consumers second and the markets third in terms of protection, and should be treated with some amount of suspicion. While the regulatory body that oversees the traditional banking system has shown itself to be remarkably forward thinking and flexible in its application of existing statutes to an evolving technological ecosystem, we should make it abundantly clear that, in the spirit of free and competitive markets, protecting incumbents has very little to do with protecting investors or consumers[2] or promoting a market environment that is worthy of the public's trust.

In the spirit of investor protection, the maintenance of fair, orderly, and efficient markets, and facilitating capital formation, we offer the following.

Do state chartered trust companies possess characteristics similar to those of the types of financial institutions the Commission identified as qualified custodians? If yes, to what extent?

As is the case with fiduciary powers, to determine whether a state-chartered trust company possesses characteristics similar to those permitted to national banks is a facts and circumstances determination and relies on an analysis of both the chartering state's statute and the actual activities of the trust. As such, we do not believe it is presently possible to make a blanket determination around whether all state chartered trust companies possess characteristics similar to those of the types of financial institutions the Commission identified as qualified custodians.

In this light, we would like to respectfully offer a complementary question: do the bodies responsible for regulating state chartered trust companies meet or exceed the level of oversight necessary to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation? If, in essence, a qualified custodian is set apart from other financial service providers by 1) its internal processes and controls, 2) its ability to adequately provide custody services for a given asset class, and 3) the level of government oversight it receives, it is imperative to give some amount of scrutiny to the body overseeing

[2] Because securities laws generally refer to "investors" or "customers" and banking regulations generally refer to "consumers" or "customers" we will use these terms interchangeably.

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a given trust company. For instance, it's important to ask: does the overseeing body specialize in the regulation and oversight of banks and similar financial institutions, or are they spread thinly across a variety of organizational structures, from trust companies to insurance companies and beyond? Is the overseeing body staffed at such a level as to be able to provide the kind of oversight required to protect consumers and markets?

The state of South Dakota has been a leader in banking and financial services for many years. Our time as a South Dakota trust company, meeting the high regulatory bar set by the South Dakota Division of Banking, undoubtedly set the stage for our federal charter conversion approval with the OCC. But again, in the spirit of our initial comments, not every state is South Dakota. The state-granted charter system is largely piecemeal, with regulatory frameworks and levels of oversight varying from state to state. As such, the determination of whether or not a given state-chartered trust company meets the definition of qualified custodian requires case-by-case analysis.

The OCC is the preeminent regulatory authority in the banking space. This is not merely our opinion, but a fact set forth in the definition of bank itself, according to clause (C) of section 202(a)(2) of the Act, where the inclusion of "any other banking institution, savings association as defined in section 1462(4) of title 12, or trust company" is based on whether or not an entity meets a standard similar to national banks operating under the oversight of the Comptroller of the Currency.

Since its inception in 1863, the OCC has been on the forefront of banking innovation and regulatory oversight, and has a history of taking a proactive approach to both protecting consumers and markets and providing the necessary guardrails to ensure banking innovation can happen with the safety and soundness required of financial infrastructure. With nearly 70% of all commercial banking assets under its purview, a higher than 2:1 ratio of OCC examiners to banks supervised, and more than 150 years of setting standards for and overseeing the proliferation of what has come to be known as the federal banking system, the OCC simply sets the highest regulatory bar that a bank can reach.[3] Institutions under the oversight of the OCC are required to demonstrate their commitment to consumers and market safety in a number of meaningful, structural ways, some of which we'll highlight below.

In what ways are custodial services that are provided by state chartered trust companies equivalent to those provided by banks, broker-dealers, and futures commission merchants? In what ways do they differ? Would there be any gaps in – or enhancements to – protection of

[3] https://www.occ.treas.gov/about/index-about.html

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advisory client assets as a result of a state chartered trust company serving as qualified custodian of digital assets or other types of client assets?

To reiterate, determining the extent to which custodial services provided by state chartered trust companies are equivalent to those provided by banks requires a case-by-case analysis. It is worth noting, though, five structural differences required on the part of federally regulated banks that may or may not be presently prioritized by a number of regulatory bodies overseeing state-chartered trusts: the issues of financial and legal entanglements with the parent company and affiliates, the notion of credible challenge, the importance of consumer protection, the three lines of defense, and risk-based capital adequacy.

Financial and legal entanglements with the parent and affiliates

To function in the best interest of consumers and markets, it is beneficial for qualified custodians to operate with a large degree of independence. Being dependent upon or entangled in the legal and financial structure of a parent entity throws into question for whose benefit a state-chartered trust is operating. Requiring clear demarcation between a parent entity and chartered bank[4] makes the kind of independence a qualified custodian requires to truly operate in the best interests of consumers and markets that much easier. In addition, ensuring that any affiliate or other related party transactions are conducted on an arm's length basis at market terms[5] is paramount for acting in the best interest of customers and the financial system as a whole, and understandably mandated by the OCC.

Credible challenge

For federally-regulated trust banks, the principle of independent operation is more than an "on paper" determination, and is augmented by the concept of credible challenge, or the "method that directors use to hold management accountable by being engaged and asking questions and eliciting any facts necessary, when appropriate, to satisfy themselves that management's strategies are viable" to appropriately manage risk.[6] Beyond legal and financial independence from a parent entity, board oversight must also be independent to the degree that a board has enough experience in banking in general, insight into the bank's operations specifically, and authority to act on that information to exert

[4] 12 USC 371c and 371c-1
[5] 12 CFR Part 223 (Regulation W)
[6] OCC, Comptroller's Handbook, Corporate and Risk Governance, pg 117; https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/corporate-risk-governance/pub-ch-corporate-risk.pdf

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meaningful influence over the bank itself. This kind of independence is integral to a bank's ability to operate in the best interests of consumers, markets, and capital formation.

Consumer protection

Federally chartered banks are also required to comply with the Gramm-Leach-Bliley Act[7], a law that aims to protect the financial privacy of consumers by limiting the disclosure of certain nonpublic personal information, and requires financial institutions to periodically inform customers of how their information is shared as well as their right to opt out of its sharing. While states may have their own consumer protection statutes in the forms of privacy laws and requirements for some degree of independent oversight, this again is a piecemeal system, requiring case-by-case analysis to determine adequacy. In addition, pursuant to 12 CFR 9.9(c), federal banks are required to maintain a Fiduciary Audit Committee in order to ensure the bank has an independent review and monitoring of its fiduciary activities. These mandated structural safeguards are ways the OCC and its related federal banking regulators maintain high levels of consumer protection. Such practices may or may not be conducted at the state level and any determination requires independent, case-by-case analysis.

Three lines of defense

The OCC also takes a holistic approach to assessing and managing risk. For instance, the OCC expects the banks under its purview to maintain what it refers to as the "three lines of defense": a set of protocols, policies, and personnel structured in such a way as to best identify, measure, and mitigate a wide range of possible risks, both internal and external, especially as they relate to improper operation of the bank itself. The first line of defense we call operators—those personnel responsible for the day-to-day operations of the bank and the controls that guide those operations. These operators must be trained and certified as appropriate for their roles, and have a high level of expertise in digital asset banking operations. The second line of defense, fully independent from the first, is a team devoted to overseeing compliance and risk management, providing guidance on how the bank can best operate to avoid or mitigate a range of risk factors. The third line of defense is made up of an additional audit function to monitor both the operators (first line) and the compliance team (second line). This audit function may be either internal or external, but must operate with full independence from the other two lines of defense, and reports directly to the bank's board. This system helps to ensure that the bank is well insulated against the possibility of mismanagement, has processes and policies in place to mitigate a wide range of

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[7] 12 USC 1811

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potential risks, and eliminates the kinds of single points of failure that can exist in the absence of this defense.[8]

Risk-based capital adequacy

A similarly holistic approach to assessing and managing risk also extends to what is required in terms of capital adequacy for national banks.[9] For state-chartered institutions, capital adequacy rules run the gamut, from requiring trusts to maintain low, seemingly arbitrary sums on hand in case of emergency, to others who require capital to scale infinitely with the size of the institution. The OCC, instead, uses a risk-based approach to capital adequacy—one that initially assigns and periodically adjusts capital adequacy requirements based on the particular risks a specific institution may be exposed to. For Anchorage Digital Bank, the process of determining an adequate level of capital involved a wide range of modeled scenarios, from those involving market risks like prices and fee compression, to strategic, compliance, operational, and legal risks. Ultimately, this kind of approach prevents the undercapitalization that can result when states set a small, arbitrary, and static number as adequate, as well as the undue burden of requiring infinitely scaling capital reserves.

How do advisers assess whether an entity offering custodial services satisfies the definition of qualified custodian in the Custody Rule? What qualities does an adviser seek when entrusting a client's assets to a particular custodian? Do the qualities vary by asset class? That is, are there qualities that would be important for safeguarding digital assets that might not be important for safeguarding other types of assets? If so, what qualities and why? Should the rule prescribe different qualities based on asset class, or should the rule take a more principles-based approach and allow advisers to exercise care in selecting a custodian?

At the highest level, advisers essentially assess entities offering custodial services in much the same way: they want to determine whether a would-be custodian is adequately regulated, has an adequate history of holding and servicing a given asset class, meets all applicable requirements around auditing and internal controls, and can help facilitate the kind of reporting that the function of Investment Advisor necessitates. Before digital assets, this kind of high level assessment was sufficient to determine whether or not an entity offering custodial services could meet the definition of qualified custodian.

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[8] OCC, Comptroller's Handbook, Corporate and Risk Governance, pg 42; https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/corporate-risk-governance/pub-ch-corporate-risk.pdf
[9] 12 CFR 3

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Digital assets, though, are fundamentally different from traditional asset classes from a technological perspective. As such, they have no easy corollary among those assets held by traditional custodians. This means that experience holding, securing, and servicing one says little about an entity's ability to hold, secure, and service the other.

It may be helpful to think about this by way of analogy. Consider the auto mechanic who has been fixing internal combustion engines for decades—indeed, for the entirety of her career. She has seen numerous incremental improvements to internal combustion engines and related mechanics as the auto industry itself evolved. She is, for all intents and purposes, an expert in automobile maintenance, and no one would question her skills to repair or maintain any of a number of gas-powered automobiles. Despite a career's worth of experience and unquestioned expertise in the repair and maintenance of what have been known widely as "cars," her expertise does not automatically translate to the maintenance and repair of "cars" with electric motors. Even though the motor in an electric car performs essentially the same function as an internal combustion engine—at least in terms of being the animating force in an automobile—the mechanism by which it performs this function is completely different from a technological standpoint. The ability to service one has little to no bearing on the ability to service the other.

The difference here, between legacy financial instruments and digital assets, is essentially the same: while digital assets and more traditional financial instruments may perform similar functions in terms of storing or transferring value, acting as an instrument of record, and so on, they are fundamentally different technologies, and expertise in handling legacy instruments does not translate 1:1 with expertise in securing, handling, or otherwise interacting with digital assets.

For this reason, we offer a resounding "yes" to the questions of whether qualities vary by asset class, whether some qualities are more important for safeguarding digital assets than other types of assets, and whether the Custody Rule should prescribe different qualities based on asset class. Perhaps the most important differentiating qualities of digital assets are the immutable nature of the blockchain, the irreversibility of transactions, and the bearer nature of the assets themselves, all of which present unique challenges for secure custody and asset servicing beyond what is required to custody securities, fiat currencies, or any other legacy financial instrument. For these reasons, we propose the following as baseline requirements for any entity providing custody services to meet the definition of qualified custodian in the digital asset space.

Proof of exclusive control

Intended to prevent, in the event of an entity's untimely failure, the delay in or inability to return an investor's securities to them, Securities Exchange Act of 1934 §15c3-3(d) ("the Customer Protection

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Rule") makes a number of requirements of broker dealers and those who provide custody services. Among these is the requirement "to maintain physical possession of or control over customers' fully paid and excess margin securities."[10] While not directly relevant to Investment Advisors, we find the rule illustrative with respect to consumer protection more generally, and specifically with respect to digital asset custody. In the realm of digital assets, a custodian's ability to simply prove 'physical possession or control' of private key material is not enough. Why? Because digital assets are fundamentally different from traditional financial instruments in terms of technology.

Private keys—the cryptographic tools that grant access to a user's digital assets—can exist in multiple instances and locations. This means that, even if a custody provider can prove possession and control of private key material on behalf of their customers, other copies of that private key material can and often do exist apart from the copy held in custody. For this reason, we believe that, to meet the definition of qualified custodian in the digital asset space, an entity seeking to provide custody services must be able to prove exclusive control over the private key material corresponding to a given wallet.

Because of the nature of cryptographic assets, access to asset private key material is equivalent to access to the underlying assets (what we mean by digital assets having a "bearer nature"). The work of digital asset custody, then, is essentially the secure custody of private key material. The notion of exclusive control – that the assets are held exclusively by a custody provider because the asset private key exists exclusively within the custody provider's control – is critical. Proof of exclusive control can be securely achieved through a combination of software, hardware, and operational processes. However, custody models that rely on private key redundancy (maintaining multiple physical or electronic copies) and physical security as a proxy for digital asset security can't ever truly prove this. Not only that, but the simple existence of multiple copies of the same key within custody multiplies consumer risk by expanding the surface of attack and increasing the number of opportunities for internal collusion and theft. We urge the SEC to look closely at this capability, as well as whether custody models whose security relies heavily on redundancy can operate in the best interest of consumer protection.

Proof of existence

Beyond proof of exclusive control, the ability to prove the existence of assets held under custody on a regular basis, or when requested by auditors or regulatory bodies, is also essential for consumer protection. In essence, proving possession of private key material is of little use if an entity providing custody services cannot also prove that the associated assets exist on a regular basis. We believe that, to best satisfy the requirements of a qualified custodian for digital assets, existence proofs on a regular

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[10] https://www.sec.gov/divisions/enforce/customer-protection-rule-initiative.shtml

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cadence are necessary. In addition, in a January 18, 2018 Staff letter,[11] the Staff strongly signaled that validating "existence, exclusive ownership and software functionality of private cryptocurrency keys and other ownership records" are key requirements for registered funds using custodians to assess. We are therefore of the opinion that qualified custody of digital assets should require the ability to prove asset existence when requested; doing so validates that the private keys exist, that the private keys are functional, and that they are held exclusively in the name of the proper parties.

Hardware security

We believe that the twin goals of exclusive control and regular existence proofing are best met by using single-purpose hardware security modules (HSMs) for key generation and storage.

On the first point, HSMs themselves can generate and store private key material without the need for that material to ever leave the HSMs, thus ensuring exclusive control.

On the second point, existence proofing via HSM-based architecture is easily and nearly instantly conducted through challenge-response authentication, which is not true of custodial solutions that rely on redundant copies of private keys as part of their security model. HSMs are also easily auditable by clients or third party auditors. Anchorage itself has had the validity of our claims surrounding the security of our HSM-custody model audited by independent security firm Bishop Fox and our ability to meet stated control objectives audited by Ernst & Young. We have helped our clients provide sufficient evidence to their external auditors as well.

Beyond facilitating these key consumer protection processes, when air-gapped and physically isolated from public network connectivity, HSMs provide a version of offline so-called "cold" storage that doesn't require key sharding or the kinds of manual human operations other forms of cold storage typically rely on—all operations that introduce the possibility of human error, theft, or compromise, and can ultimately result in asset loss.

HSMs also benefit from being well-known, mature, and rigorously tested technology. To this day, NATO militaries, major financial institutions, and many large technology companies already leverage HSMs whenever they have significant key management challenges. We believe that applying this same kind of technology to digital asset custody—essentially a very large scale exercise in key management and security—makes long-established security best practices the cornerstone of digital asset infrastructure. Relying on HSMs for digital asset custody also makes existing, long-established, and regularly reviewed

[11] https://www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm

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federal standards for private key security foundational to a custodian's security architecture. The National Institute of Standards and Technology has developed the Federal Information Processing Standards (FIPS), standards and guidelines developed for use by the Federal government, approved by the Secretary of Commerce. HSMs rated FIPS 140-2 meet the stringent security requirements needed for cryptographic modules.

With custody as foundational as it is to the secure scaling and operation of the digital asset ecosystem, it is imperative that, for any entity to truly live up to the definition of qualified custodian for digital assets, they meet or exceed the kinds of security standards already long-established for private key security outside the financial world. Doing so is the best way to meaningfully prioritize consumer protection in digital asset custody.

Blockchain monitoring

A last requirement to be, in our view, at a level of technical proficiency sufficient to securely custody digital assets, act as fiduciary, and meet the definition of qualified custodian for the digital asset space is the ability to proactively monitor the blockchain. There are currently thousands of digital assets in existence, with more being constantly developed at various levels of operational security and soundness. To act in the best interest of consumers, markets, and capital formation, it is the responsibility of qualified custody providers to assess the distributed ledger technology and associated network by which a given digital asset is logged and transferred. As we have mentioned, digital assets present unique security concerns, and any vulnerability at the protocol level stands the risk of being exploited, potentially at scale. The inability or unwillingness of an entity to assess and monitor a given blockchain's integrity, as well as implement policies and procedures around periodical evaluation of changes to that blockchain puts consumers and the market at risk of material loss. For these reasons, we believe it should be a nonnegotiable requirement for a qualified custodian in the digital asset space to not only have the ability to proactively monitor the blockchains for those assets they wish to support, but to implement clear policies and procedures for doing so on a regular cadence.

Are there entities that currently satisfy the definition of qualified custodian under the Custody Rule that should not be included within that definition because they do not meet the policy goals of the rule? If so, which ones and why? Conversely, are there entities that currently do *not* satisfy the definition of qualified custodian but should? If so, which ones and why?

Based on the aforementioned, we respectfully believe that there are entities currently operating as if they satisfy the definition of qualified custodian under the Custody Rule that should not be included in that definition with respect to digital assets because they do not meet the ultimate policy goals of the Rule. As

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stated above, custody models that rely on redundancy and physical security as a proxy for digital asset security fail to meet the requirements to prove existence of and exclusive control over a given wallet, and essentially expand their surface of attack in the name of security. We do not believe these practices serve to protect the best interest of investors, aid in facilitating capital formation, or ultimately enable fair, orderly, and efficient markets.

At the root of the question—”the ultimate policy goals of the rule”—is the notion of fiduciary responsibility. Thus far, based on the unique characteristics of digital assets, we have argued that qualified custodians in the digital asset space should have to meet a number of specific technical and structural requirements. It follows that, due to the technological particularities of digital assets and the risk of permanent and irreversible loss that accompanies them, what is required of a fiduciary in the digital asset space should also differ. We respectfully suggest that a fiduciary in the digital asset space must meet an even higher bar than one in the realm of legacy finance.

Beyond the ability to prove exclusive control, prove the existence of assets, use hardware security structures and monitor the underlying blockchain, which we deem essential, it is our opinion that fiduciaries in the digital asset space should be subject to the same kind of structural requirements as banks under the purview of the OCC.

Financial and Legal Independence

Codified independence is essential for ensuring that financial institutions are able to act in the best interest of customers and the financial system as a whole, and should be considered fiduciary requirements in the digital asset space. The concept of independence is rooted in statute, from 12 USC 371c and 371c-1, which, among other things, requires a clear demarcation between a chartered bank and its parent entity, to 12 CFR 9, which requires the seating of a fiduciary audit committee for the board in order to ensure independent review and evaluation of fiduciary activities, to Regulation W, which was put in place to ensure that affiliate and related party transactions are conducted on an arm’s length basis at market terms. In each of these instances, independence functions as a check on bank mismanagement and in the interest of consumer protection.

Credible Challenge

A fiduciary's board of directors must not only be independent, but informed by the concept of credible challenge, and empowered to alter the direction of the bank itself if and when its actions are at odds with fiduciary responsibility

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Consumer Protection

Fiduciaries in the digital asset space should also be held to the highest standard in terms of consumer protection. That means strict adherence to GLBA to ensure consumer privacy is protected. In addition, pursuant to 12 CFR 9.9(c), federal banks are required to maintain a Fiduciary Audit Committee in order to ensure the bank has an independent review and monitoring of its fiduciary activities.

Three Lines of Defense

Particularly in the digital asset space, a fiduciary should maintain a set of protocols, policies, and personnel structured as three lines of defense to best identify, measure, and mitigate a wide range of possible risks, both internal and external, especially as they relate to improper operation of the fiduciary.

Risk-based Capital Adequacy

Fiduciaries must take an in-depth, risk-based approach to operational expense capital, ensuring an institution has adequate capital to protect consumers against a wide range of risks while still being able to operate in the best interest of markets and capital formation.

In closing, we would like to reiterate the fact that digital assets have no perfect technological analogue in the wide history of financial instruments up to now. As such, for an entity providing custody to digital assets to meet the definition of qualified custodian—to truly meet the policy goals of the rule—they must meet an exceedingly high bar in terms of being able to hold and service the assets themselves, in terms of regulatory oversight, and in terms of concrete, structural, and operational commitments to consumer protection. Given the particular technological realities of digital assets, it is not possible to make blanket statements around whether or not state-chartered trust companies meet the definition of qualified custodian under the custody rule, and determinations should be made on a case-by-case basis, as they have been historically.

Anchorage Digital Bank NA would be more than happy to provide additional information or respond to any need for clarification the Commission may require relating to these matters.

Sincerely,

DocuSigned by:

Nathan P McCauley

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Nathan McCauley

Co-Founder and CEO

Anchor Labs Inc.

Anchorage Digital Bank NA

DocuSigned by:

Georgia Quinn

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Georgia Quinn

General Counsel

Anchor Labs Inc.

Anchorage Digital Bank NA