THE DEBANKING DILEMMA

AIMA

AIMA Calls for Action on Banking Challenges Faced by Crypto Hedge Fund Managers

The crypto hedge fund industry has seen sharp growth over the past few years – reaching $15bn AUM as of December 2023[1]. However, this growth comes despite significant obstacles to basic, low-risk banking services. In AIMA and PwC's 2024 Crypto Hedge Fund report, "access to banking rails" was identified by crypto hedge funds as the number one area of the market's infrastructure most in need of improvement.[2]

The existence of this problem across the US crypto industry more broadly, and speculation on the ultimate cause (colloquially referred to as "Operation Choke Point 2.0"), is being widely discussed currently across traditional and social media. Yet, despite significant anecdotal evidence[3] within the crypto sector, there has not been a comprehensive survey of the crypto hedge funds detailing their difficulty in accessing banking services in the US.

To address this gap and raise awareness of the potential harm to this segment of the private funds industry, John D'Agostino, Co-Chair of the AIMA Digital Asset Working Group (AIMA DAWG) surveyed 160 crypto hedge fund firms. A control group of 20 "traditional" alternative investment managers and 40 crypto technology firms was also surveyed to provide comparative insights. Respondents were asked about their experience in securing basic banking services over the past three years.

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[1] https://visiontrack.galaxy.com/dashboard/. From December 2023 to 2024, the crypto liquid market cap has doubled from $1.8trn to $3.6trn today, and as such, a 2024 estimate of AUM would be $30bn

[2] https://www.aima.org/compass/insights/digital-assets/6th-annual-global-crypto-hedge-fund-report-2024.html

[3] https://x.com/davidmarcus/status/1861752495933935871
https://x.com/pmarca/status/1862635456204341739?t=i9qbinhe9sqVqiYyiLi-7g&s=09
https://www.ar.ca/blog/my-bank-forced-me-to-use-defi
https://x.com/CaitlinLong_/status/1863220194166067294

KEY FINDINGS:

While none of the traditional alternative investment managers have lost or been denied banking services for their funds or management companies, 75% of crypto hedge fund firms reported issues with accessing/growing banking services for their funds over the same period and 67% reported issues with accessing/growing banking services for the investment manager. This stark disparity raises concerns about the inclusivity of the current financial system, as well as the potential long-term impact on innovation and economic growth in the US crypto space.

Survey methodology
The survey, conducted in October 2024, included 160 crypto hedge fund firms, 20 traditional alternative investment managers and 40 crypto technology firms. Respondents were sourced via relationships with multiple service providers across the US to limit concentration bias by state or client type/size. The survey focused on basic cash management services, such as access to checking accounts used for vendor payments, rent, and salaries.

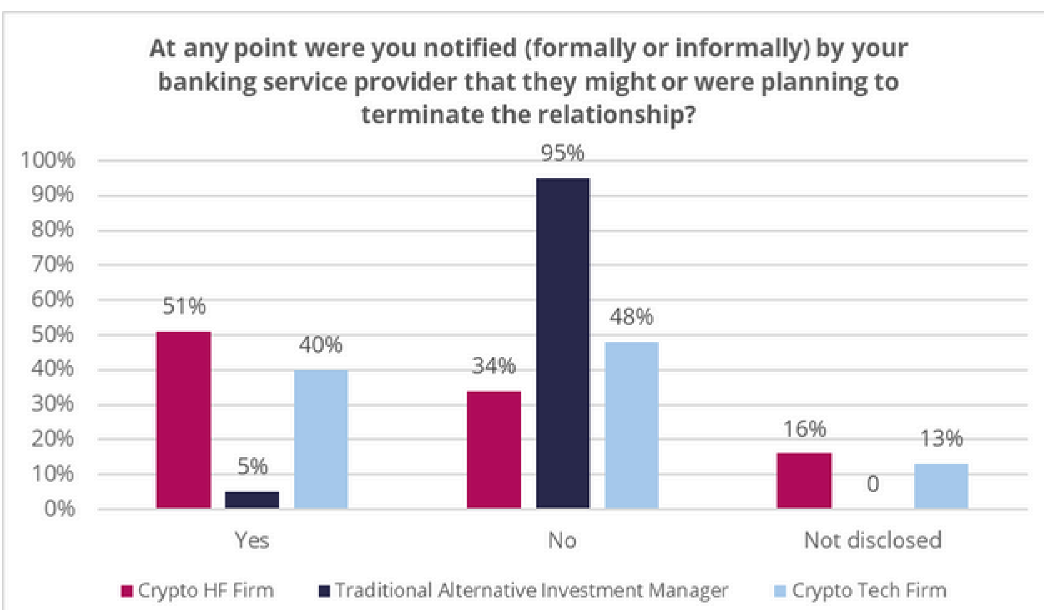
Basic cash management accounts are generally considered low-risk and beneficial to banks. Further, these accounts are typically seen as safe entry points for winning additional business, such as high-net-worth services for fund founders and portfolio companies.

ADDITIONAL INSIGHTS

Account Termination:
Just over half of the crypto hedge fund firms surveyed indicated they were notified (formally or informally) by their banking service provider that they might or were planning to terminate the relationship. In 98% of these cases, no reasons were disclosed. For the 2% of funds that did receive an explanation, the banks cited a limit on crypto customers and crypto industry exposure.

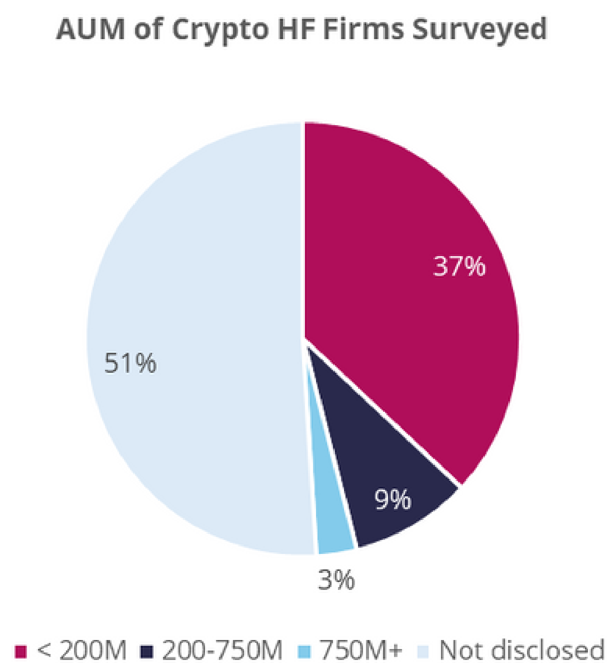
Comparison with Traditional Alternative Investment Managers:
By contrast, only one traditional alternative investment manager reported a similar notice and in that case, was provided with a clear explanation. Among the crypto technology firms that were surveyed, 40% were notified about a potential or pending termination and none were provided with a reason.

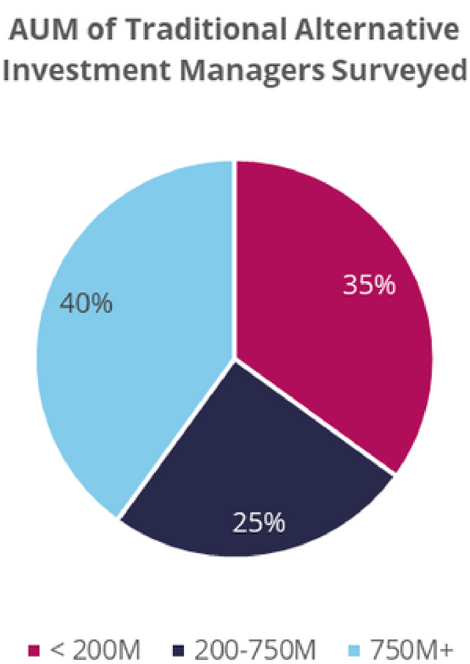
Bank Engagement Practices:
Generally, a sales team will work closely with potential clients to assist them through the onboarding process. If problems arise, potential clients are normally coached through them. If the onboarding issue is insurmountable, there is normally no confusion as to the cause. In the case of crypto, banks were unable or unwilling to even provide information to potential clients as to what their failings were.



Comparison of Traditional Alternative Investment Managers and Crypto Hedge Fund Respondents:

In order to control for bank access decisions that might be impacted by factors outside of asset class, respondents were also asked about the AUM, registration status and controls.





It is fair to note that banks, particularly larger ones, will sometimes avoid working with smaller clients, but there is healthy competition for these new manager clients, and many banks have departments that focus on winning smaller mandates with potential for growth. Given that over a third of the control traditional alternative investment manager group are under 200M AUM, there appears no reason that size, on its own, would explain the survey results.

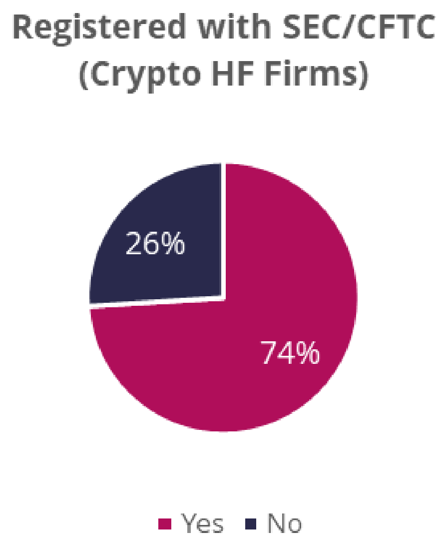
Another meaningful difference in the data sets is around registration with US regulatory agency, either the Securities and Exchange Commission (SEC) or Commodity Futures Trading Commission (CFTC). As expected, a higher percentage of crypto hedge fund firms had not reached the AUM size where registration was required, with only 5% of the control group reporting their funds/investment advisor were unregistered compared to roughly 26% of crypto hedge fund firms reporting the same.

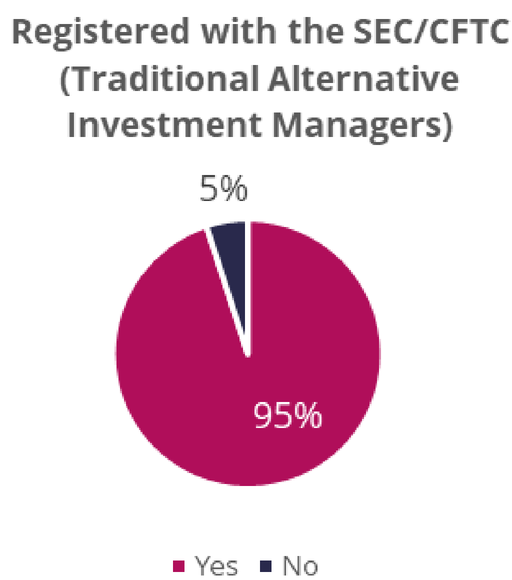
As with fund size, it is fair to argue that some larger banks might refuse to onboard unregistered funds – but as with fund size, smaller, pre-registration funds have enjoyed a wide array of potential banking partners who specialize in onboarding and growing with these smaller clients.

Funds were also asked about their use of third-party controls. 100% of the crypto hedge fund firms surveyed reported using a third party for Anti-Money Laundering (AML) services, 100% use a third party for administrative/accounting services and 100% use a third-party auditor.

Allowing for some differences in risk appetites for size and registration status, the pronounced difference in banking difficulties can only be attributed to the one unique factor among the sample sets, namely the underlying asset class.

This is further underscored by the fact that the crypto hedge fund firms surveyed have responses that far more closely resemble the results of crypto technology firms, rather than their traditional alternative investment manager peers. We also asked if the banks had asked, and thus were aware, about crypto exposure. Of those who answered the question all but one noted yes. Similarly, for the crypto technology firms, all of those who answered noted they were asked about crypto-related activities.





Impact on the Crypto Hedge Fund Industry :

The widespread challenges crypto hedge funds when accessing basic banking services has significant implications for the industry’s growth and stability in the US. Without access to traditional banking services, crypto hedge funds face numerous operational challenges. These may include difficulties in processing payments, managing cash flows, and accessing essential financial tools. The lack of banking relationships can hinder their ability to operate efficiently and compete with traditional financial institutions. As crypto companies are forced to seek alternative financial services or rely on a small number of crypto-friendly banks, they may incur higher costs and face additional risks and reduced operational efficiency. This can impact their competitiveness and ability to innovate within the industry.

The debanking trend also certainly affects investor confidence in the crypto sector. Traditional investors may be hesitant to allocate capital to an industry that faces such significant banking challenges. This could potentially slow market growth and limit institutional investors from accessing desired exposure to crypto. Furthermore, it is a hindrance to attracting talent given that these banking issues go beyond business operations but also other key banking functions such as providing mortgages to employees of crypto businesses.[4]

Call to Action

The significant discrepancy in banking access between crypto and traditional alternative investment businesses threatens to stifle innovation and hinder the growth and international competitiveness of an important emerging sector in the US. By addressing the debanking issue head-on, the crypto sector can pave the way for greater integration with the traditional financial system and unlock its full potential for economic growth and technological advancement.

AIMA urges a collaborative approach to address these systemic challenges and is committed to working with the new administration, banking leaders, and policymakers to develop solutions in the US and wherever else crypto hedge funds are unable to access basic banking services globally[5]. Specifically, AIMA calls for:

1. **Stakeholder Engagement:** Foster dialogue between policymakers, banks, and crypto industry leaders to identify actionable solutions.
2. **Proportional Risk Management:** Encourage banks to adopt risk-based, not blanket, approaches to onboarding crypto businesses.
3. **Regulatory Clarity:** Establish clear guidelines to reduce ambiguity for crypto hedge fund managers.

As the debate continues, it is clear that finding a 'system-wide' balanced approach that addresses regulatory concerns while fostering innovation will be key to resolving the debanking dilemma.

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[4] https://www.ar.ca/blog/my-bank-forced-me-to-use-defi

[5] For example, in the UK, debanking also remains a significant challenge for crypto firms, stifling growth in the digital asset market and undermining the government's vision of establishing the UK as a global digital asset hub. Industry concerns were highlighted during a roundtable hosted by the All-Party Parliamentary Group for Crypto & Digital Assets, where firms reported routine denial of banking services due to the crypto-related nature of their businesses. Over the past 12-18 months, multiple UK banks have imposed limits or terminated services for crypto and digital asset businesses. Last month, during a hearing in the UK Parliament, a member of the House of Lords raised concerns that crypto firms are facing difficulties accessing banking and professional services. Last year, the FCA reviewed banking access for such businesses, finding they were among the most affected by account declines and terminations.

To learn more or discuss please contact usa@aima.org.

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