Hot, cold and the key-management spectrum

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The hot/cold distinction concerns connectivity. A hot wallet's key is on a system connected to the internet and can sign at once. A cold wallet's key is held offline and signing requires a manual step. Every serious custodian holds the bulk of client assets cold and a small float hot to service withdrawals. The ratio is a risk decision that regulators now examine. MAS's technology risk management guidelines and its 2023 customer-protection measures expect a DPT licensee to hold most customer assets in cold storage and to justify the hot float.[1]

The legal consequence of the distinction is mainly evidential. A custodian whose hot wallet is drained has lost assets through a security failure that it will have to explain to clients and regulators. Whether the loss falls on the custodian or on the clients depends on the agreement and on the general law of bailment or deposit. A Swiss custodian is liable for loss caused by its own negligence under Art. 97 CO and cannot exclude liability for gross negligence under Art. 100 CO. A Singapore custodian's position turns on its terms, subject to the Unfair Contract Terms Act 1977 for consumer customers. Both Part D, Chapter V and Part J, Chapter III treat the drafting.

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Notes

1. MAS, Guidelines on Risk Management Practices – Technology Risk (TRM Guidelines), revised 18 January 2021, together with the custody-specific expectations in MAS's July 2023 response on DPT customer protection. FINMA addresses the equivalent expectation through its risk-based supervision of licensed custodians and, since 2026, through Guidance 01/2026. ↩

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