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How should Wealth Managers Engage Digital Assets

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How do you think mainstream wealth managers will view digital assets going forward?

It's a good question, Michael. And look, in reality, a lot of the private banks in the high-net-worth space have been treading fairly carefully in this market already. The current and recent news in this space is clearly going to increase their concerns about entering the market in the right manner, and of most importantly, protecting their client's assets. Undoubtedly, there is still strong institutional demand, and we definitely see strong interest in access to the underlying technologies, particularly blockchain and the like, and we feel there still will be very strong opportunities in this space.

In terms of access to digital assets through cryptocurrencies per se, we don't see many of the private banks looking to take and provide direct exposures at the moment, although some are providing funds-based products, and as we think about the wider digital assets portfolio, as we move through stable coins, DeFi, NFTs, again, there is talk, there is education, but I think at the moment we'll continue to see more of a watch and wait strategy rather than firms diving deeply into it, particularly given the recent press.

So, Mark, why should anybody be interested in digital assets?

Fundamentally, we need to look at the digital assets ecosystem, and what are digital assets? If you think about the landscape today, clearly there's been a lot of talk around cryptocurrencies, the Bitcoin, Ethereum, et cetera. But as we move and look across the spectrum, we have the cryptocurrencies. We've got the stable coins; these are the assets which are typically backed one for one or similar with the underlying assets of particular currency. We also look at the DeFi space, and as we move across that spectrum, we move into NFTs. These potentially offer us exposure to a number of new asset classes. And finally, as you move

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across that spectrum, you end up in the world of the metaverse. There's been a lot of talk around metaverse, the potential. In reality today, it's largely being used as a training and an L&D, and a marketing tool. But we do foresee opportunities and increasing focus in that space.

So, coming back to your question, "Why should people be looking at the space today?" Well, fundamentally, it's about investing in new technologies and future opportunities. Clearly, there's been a lot of noise around digital assets, and we need to look at that very, very carefully. And as we've said in previous discussions, trust is very, very important, and we'll probably come back to that. If we think about opportunities, undoubtedly a number of people today spend a lot of time in the digital world. If we look at many of us who have kids who are spending time in the world of Fortnight, Roblox and others, and we see these technologies being used and similar across the board. Undoubtedly the future will have a mixture of online, offline, DeFi, CeFi coming together, so there will undoubtedly be opportunities for wealth managers in this ecosystem.

For a lot of investors today, it's really about getting exposure to the underlying technologies. We still feel that blockchain offers a lot of opportunities going forward, and potentially can have a lot of implications across the wider financial services ecosystem. Particularly as we think about the benefits we gain from immutability, from transparency, and of course align with that the potential to speed up the whole of the transactions behind the financial market system. So as we talk about the potential for a real T0 world, it will most likely be blockchain technologies that underpin that.

How can a wealth manager try and help clients that are interested in finding out more information about digital assets?

Clearly the first question is to understand where your client is coming from. Some of them may just be coming to you to try and get a better understanding of the landscape itself, before they even invest. So fundamentally, when we often talk to our clients in this space, it's to understand, what is the exposure they're trying to take? Is it to the technologies? In which case, it may be most relevant to invest via VC or potentially private equity-based funds, particularly the pool vehicles, given the risk in the system and you want to diversify your portfolio.

Some clients may want exposure purely to cryptocurrencies. In many cases, that's not a product that the private banks are providing, although they may provide access to a wider range of products through some form of fund. But fundamentally for an RM, I think it's important to be able to discuss, qualify, and also educate. Clearly there are options in this space, but it is important to understand the risks that are involved and are equally aligned with your house view in terms of how these technologies will develop.

And what are some of the risks, and how can they be mitigated?

Clearly, given recent news, there's a lot of focus on the risks and making sure firms are doing the right thing by their clients. Now, fundamentally, we have seen potential fraud in the industry, or in other cases, it's just been hacks and cyber weaknesses or other failures in the overall structuring of some of these products. I think the key is always around trust. This is why a lot of our clients are coming to the existing wealth managers because these firms are trusted. Number one, custody, or safekeeping my assets, that's clearly been an area of focus in a lot of cases.

More recently, we've had a lot of conversations about whether those assets are really there. So in the last few weeks we've had a number of conversations with clients about proof of reserves (PoR). We've had firms come in saying, "Well, can you come and do a proof of reserve attestation for us, to provide comfort to our clients?" But in reality, we're not sure that's necessarily the answer that we should be looking for. In the sense of, proof of reserves is a point-in-time assessment of whether those assets exist. Clearly, assets can come and go. So, from our perspective, we are offering these services, but it is important that it's typically on a reoccurring basis and very much aligned with controls reviews.

Many of the challenges in today's market are because the controls weren't necessarily there or implemented in a robust manner. If you look at the leading firms in this space today, many of them have the traditional SOC 1s, SOC 2 type controls, attestations. They've also got, typically, big four auditors reviewing the processes, checks and balances are actually in place appropriately. So, I think fundamentally a lot of the challenges are around trust, and we as an industry need to make sure that we are transparent, we are working with the regulators and the wider ecosystem, the lawyers, the big four, and the like, to make sure that we have the right governance controls and can provide the comfort to this ecosystem. I think this is going to be fundamental as the markets mature. ■