WealthBriefing
News Insight Intelligence

DECODING THE DIGITAL LANDSCAPE FOR UHNWIs

This report explores the digitalisation of - and digital assets in - Jersey's wealth management sector. It explores the shifting sands - both economic and regulatory - on which the digital sector rests.

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INTRODUCTION

A recent webinar on the subject of digitalisation and digital assets in Jersey's wealth management sector explored the shifting sands – both economic and regulatory – on which the digital sector rests. There are many lessons to be learnt from these discussions and all of them are published in this report, along with plenty of insights from trustees, private bankers, wealth managers and experts who constantly provide *WealthBriefing* with editorial advice.

The digital-asset sector now represents a trillion-dollar alternative asset class. Ultra-high-net-worth ("UHNW") investors who are looking for International Finance Centres in which to invest have become very aware of various types of digital asset and some of them have become very enthusiastic, although take-up has been measured. Members of the webinar panel tended to talk about high-net-worth involvement in these assets in the present tense rather than the future, but this is an area in which many jurisdictions are still treading carefully.

Custody is often a frustration for wealth managers who are brave enough to enter this field, with the recent FTX scandal having tested the trust of many investors in custodial wallet services to breaking point. The Jersey Financial Services Commission has been very keen to promote blue-chip crypto-projects – a sign that it is being selective in its choice of firms to authorise. This ought to stand the island in good stead in the event of similar circumstances.

The panel discussed the use of Artificial Intelligence ("AI") in onboarding and other functions as a possibility, although few private bankers and other wealth managers seem to be using it for that purpose at present. It looked forward to a future in which AI took care of repetitive tasks, freeing up time for relationship managers, trustees and others to concentrate their attention on creating new relationships and enhancing existing ones with their UHNW clients. It also explored non-fungible tokens or NFTs, a phenomenon that is popular in the art world but not yet commonplace among family offices and UHNW investors. It is still early days for UHNW investment in digital assets.

Jersey has a very strong regulatory reputation upon which the digital assets industry can draw in its attempts to become established. There is no doubt about the island's ability to enhance its already-robust platform for digital assets. Jersey is stable, both politically and fiscally, which is an important consideration when identifying an appropriate jurisdiction in which to locate your structure. Jersey's modern and enabling corporate law regimes, partnership regimes and other regimes make it an attractive jurisdiction in which UHNW investors might hold these assets.

Chris Hamblin - Editor
ClearView Financial Media,
publisher of *WealthBriefing*

DIGITAL ASSETS AND CRYPTO-CURRENCIES

In conjunction with **Jersey Finance**, ***WealthBriefing*** recently recorded a webinar that ranged over the subject of digital assets, crypto-currencies and the ways in which they relate to international financial centres.

On the panel were: **Naomi Rive**, the Head of Private Wealth at Highvern Trustees in Jersey; **Heather-Anne Hubbell**, a former Lawyer and Risk Manager and the Founder of Phundex, a Jersey FinTech firm, who also trains people at financial institutions in governance; and **James Brockhurst**, a Private Client Partner at the law firm of Forsters in London. **Stephen Harris**, the Founder and CEO of *WealthBriefing*, the world's premier wealth-management website, was in the chair.

WealthBriefing recently polled its editorial board – a large mixture of wealth managers and experts from around the world – to ask its members how they were dealing with digital assets and digitalisation in general. In reply, they said that only a tiny proportion of the families with which they worked focused on digital assets and even those tended to hold those assets outside their wealth-management structures.

One firm said that these things accounted for less than 5 per cent of its assets under management. Another said that its clients had no appetite for them and added that the area had been underperforming. Some wealth managers said that they did not manage digital tokens or coins because they carried high risks – potential money laundering or fraudulent activity – and were not regulated in most locations.

Members of the webinar panel, for their part, tended to talk about high-net-worth ("HNW") involvement in digitalisation and digital assets in the present tense rather than the future.

Assets in a digital form

What do wealth managers actually mean by digital assets and what are their functions and characteristics? Crypto-currencies are the most prominent digital assets, but Heather-Anne Hubbell was careful to note that ultra-high-net-worth ("UHNW") clients were very aware of many others, such as non-fungible tokens or NFTs.

"Digital assets are assets in a digital form – things like photographs, logos and illustrations. They've become very popular new opportunities for investment, in particular because you have the ability to manage the metadata that goes around them. They can be encrypted securely, which helps make them a more secure investment.

AN NFT IS A DIGITAL REPRESENTATION OF AN ASSET WHICH ITSELF IS NOT NECESSARILY DIGITAL.

"People need to understand that the technology behind crypto-currency is actually the technology that helps to build the digital assets, which makes them secure and safe… different than the concept of crypto-asset trading, which is taking an asset and putting it on a trading platform that may not have the same level of security."

The digital-asset sector now represents a trillion-dollar alternative asset class, so it is hardly surprising that family offices and UHNWs are keen to know more about it and, in many cases, are tapping into it already.

An NFT is a digital representation of an asset which itself is not necessarily digital. Anybody can take a known piece of art and create a representation of it in the form of an NFT. Investors can then use it as a security that they can buy and sell. NFTs are very popular in the art world at the moment and family offices and organisations might find them interesting in future.

Out of all the HNW clients that *WealthBriefing's* collection of wealth managers and experts serve, almost none use NFTs or digital works of art, although one has NFTs in development. One response was typical of the rather cautious approach that wealth managers are taking in this field.

"We do allow (non-digital) works of art and chattels to be held under trusts. The proportion of our total AuM that this represents is less than 2 per cent. We do not hold digital assets (crypto/NFTs/coins) but we do allow investments in blockchain technology."

Another wealth manager wrote: "Only one entrepreneur I work with (under 40) is developing businesses in the metaverse and related NFTs (and) is keen on this area."

Naomi Rive, for her part, was certain that the HNW world was interested in digital assets.

"We of course know that inflation rates have been very high, particularly over the last twelve months, so the more traditional financial routes to investment are changing a little. UNHWs want to dip their toes in the water and to make sure that they are not missing out on the next big opportunity. I think the prospects of those higher returns and more portfolio diversification are really what are attracting those clients."

The panel generally agreed that it was still early days for UHNW investment in digital assets, noting that mainstream institutional investors had started to invest in crypto-businesses as well, spurring further confidence in them. In the middle of the last decade, only small groups of individuals held digital assets, notably Bitcoin and Ethereum. Since then, hedge funds have moved into the market in a big way, with the private-client sector following along behind.

Custody and privacy at issue

James Brockhurst of Forsters observed that private banks in London, Switzerland, the United Arab Emirates, Singapore and other jurisdictions were taking an interest and that institutional custodians were playing an ever-increasing part.

HOW DO YOU REGULATE AN INDIVIDUAL? IT'S DIFFICULT.

"The $64-billion question remains custody – and more so, following the collapse of FTX. So many hedge funds and private-wealth investors, including family offices, are now looking at serious custody options whereas perhaps they weren't before. I have set up one family office specifically for a crypto-individual, but in terms of traditional family offices, they are looking at things like ring-fencing. "How safe are the assets if you deposit them with an exchange? How safe are the assets if you deposit them with a custodian?

"I also think that privacy plays a big part in the development of digital assets with HNWs because, if you look at the transparency initiatives that we've had in the last five or ten years with the likes of the (Organisation for Economic Co-operation and Development's) Common Reporting Standard and the US *Foreign Account Tax Compliance Act* and automatic information exchange, digital assets don't yet fit neatly into those information-sharing regimes. We have banks, exchanges and custodians involved, but it remains the case that a lot of crypto is almost a sort of self-custody, peer-to-peer activity. How do you regulate an individual? It's difficult."

PRIVACY PLAYS A BIG PART IN THE DEVELOPMENT OF DIGITAL ASSETS WITH HNWs.

Heather-Anne Hubbell agreed that regulation was still "a challenge" and "trying to catch up," but thought that the situation was improving.

"If there are more offerings, it's easier to deal with. For example, digital assets raising income and then being able to put the money in a bank. If you are trying to explain to the jurisdiction that they are in (such as Jersey) the source of wealth, you need to be able to actually understand what it is that you're talking about. The regulators are becoming more aware of it."

The double-edged sword of reputation

Stephen Harris, the founder of *WealthBriefing*, had his own perspective on the significance of digital assets for International Financial Centres ("IFCs").

"This is very much about reputation, isn't it? It's about having an asset or an asset class that you trust and have a good feeling about. That must impact upon the jurisdiction that it's held in and I suppose it goes both ways. If you have an asset class that enhances the reputation of the jurisdiction, does the jurisdiction enhance the reputation of the asset class as well? Is this a symbiotic relationship, perhaps?"

Naomi Rive had an answer: "When you start looking more closely at digital assets – and we've all had to do that as part of liaising with clients and onboarding – you start to realise that a lot of the risks associated with digital assets are very similar to risks that we've seen across other asset classes over time as well.

You start to realise that, actually, all of the attributes that you have as an IFC are attributes that are very important in this sector as well.

"We know that Jersey and some other IFCs have a very strong regulatory reputation. We've...always embraced regulation so we can leverage a lot upon that in order to develop a very robust platform for digital assets for clients. Again, we have political stability and tax stability, which are very important in this area, and we have very modern and enabling corporate law regimes, partnership regimes and different regimes for holding these asset classes.

WE KNOW THAT JERSEY AND SOME OTHER IFCs HAVE A VERY STRONG REGULATORY REPUTATION.

"This is a trillion-dollar industry now. There are a lot of service providers that need infrastructure and a business place in which to operate. We have the exchanges. We have the software developers, the custodians, the data-service providers and mining companies. They all need to locate themselves somewhere. Through Jersey's attitude towards innovation, the Digital Jersey Hub that it operates and the correlation between industry and the regulator over here, there's a lot that IFCs can do to attract that business onto the island and provide a really substantive platform."

A reputational risk for IFCs?

It is definitely the case that digital-asset businesses can benefit a great deal by dealing with – or locating themselves in - IFCs such as Jersey, but can they pose a reputational threat to the IFCs themselves?

Naomi Rive thought so: "I don't think that any jurisdiction would want to create the sense that it's a free-for-all for digital assets. Things have to be done in a controlled way. I feel that the definition of digital assets is still evolving, so you have to be quite careful as well not to run ahead of yourself and seek to over-regulate or over-legislate for an area that is very innovative and fast-moving.

"In Jersey we focus on the areas where we know our core strengths lie and develop those areas to mitigate the risks that exist. I do think that this is an area where a lot of jurisdictions are still treading carefully. Equally, however, it's not a sector that is going to wait around for us to develop an infrastructure. If we don't seize the opportunity, invest in getting the right skills and talents on the island and get the right innovations in the sector, other jurisdictions will run ahead."

Physical location

Stephen Harris wondered whether physical location was at all relevant for digital assets and asked the panel to identify the drivers and barriers to making an IFC the best-of-breed for digital-asset users.

Brockhurst, once again, emphasised custody.

"I know clients who would rather have their digital assets custodied in a larger jurisdiction. We're talking (about) cold storage, the idea that you can have your assets effectively in a bot. That's what it would ultimately come down to.

"Custody is important and the location of custody is important.

"In terms of the barriers, we're back on the reputational risk. A lot of trust companies moving in this space have a lot to lose, because we've seen things blow up already and, as this becomes more prevalent, things will blow up again. Trust companies, I've noticed, with younger boards seem to be more willing to enter the space, whereas other trust companies are taking a more cautious approach, seeing what their rivals are doing."

PHYSICAL LOCATION IS IMPORTANT. THERE'S A LOT TO LOSE IF THIS ISN'T DONE CORRECTLY.

The Jersey Financial Services Commission ("JFSC") – Jersey's all-in-one financial regulator – has been very keen to promote blue-chip crypto-projects. Brockhurst took this as a sign that it was being selective in its authorisations, which he thought would stand the jurisdiction in good stead if and when there were a scandal.

"I've had projects come to me and in a couple of cases I've said: 'Don't bother going to Jersey, because I know that the regulator will push back for good reason, because you don't have any experience in this sector.' If they want to set up a crypto-fund but they haven't got any experience as fund managers, (or) any track record in the industry, Jersey is not the jurisdiction for them. For IFCs to have that robust reputation, you have to only really promote those blue-chip projects. So yes, physical location is important. There's a lot to lose if this isn't done correctly."

The technological eco-system

The panel then moved onto the ways in which jurisdictions could maintain and develop a type of eco-system that is relevant to digital assets. Heather-Anne Hubbell thought that the way forward was to connect digital activities to regulatory activities. This has been happening on the island for some time, with Jersey Finance, Digital Jersey and the JFSC sharing thoughts, organising sessions and working with the financial services industry. She looked forward to the authorities educating more people in the industry about the salient facts and wanted regulators to do their jobs pragmatically without throttling innovation. She added, with some understatement: "There's going to be a little bit of trial and error along the way."

Sustainability and ESG

The term 'sustainability' essentially refers to anything that can carry on indefinitely. It is used in the context of the earth's resources and climate. The United Kingdom's Financial Conduct Authority is implementing its Sustainability Disclosure Requirements soon and many other regulators all over the world are bound to follow suit. Meanwhile, the European Union now requires large and/or listed companies to publish regular reports on the social and environmental risks that they pose and on the effect that their activities have on people and the environment.

In January its Corporate Sustainability Reporting Directive came into force. As time passes, with initiatives like these, more and more UHNW investors will have access to information that can help them assess risks that arise from climate change and other phenomena. The direction of travel is unambiguous.

Jersey has a responsibility to leverage its expertise and capital to support the transition to a more environmentally and socially sustainable global economy. In 2021, *Jersey for Good: A Sustainable Future* was launched to support its vision that by 2030, Jersey will be recognised by its clients, key stakeholders and other partners as the leading sustainable finance centre in the markets it serves.

The Holy Grail

Answering a question from Stephen Harris about whether sustainability and digitalisation were mutually exclusive for financial firms and their HNW clients, Naomi Rive revealed that this was the subject of heated discussions on financial services regulatory boards in Jersey. She thought that the convergence of sustainability and digitalisation was, for many, becoming a kind of Holy Grail.

"Digitalisation in the private-client world is something we're probably crying out for and we would need to see that pushing ahead quicker than it currently is. Clients are investing in a much broader spectrum of assets now than they ever were before. It's not just the traditional financial investments any more. We've seen direct private equity investments become very popular over the years. We're now seeing digital assets as well. There's always been real-estate assets and commodity assets.

DIGITALISATION IN THE PRIVATE-CLIENT WORLD IS SOMETHING WE'RE PROBABLY CRYING OUT FOR.

"Even just getting very good, high-quality reporting around all of those assets for clients is a challenge and in some ways it shouldn't be. People focus on their own individual asset classes and components within that and we really need now to be able to pull all of those strands together to get that live-time reporting that clients are so hungry for."

She added that banking and payment processing were issues for the entire private-client sector and caused too much trouble behind the scenes. When surveyed, most of *WealthBriefing's* contacts said that digital assets were not, so far, having any effect on their banking or payment processing. One said that many banks were still not accepting digital assets under custodial services as they lacked any risk-management tools that might enable them to combat fraud, money laundering, terrorist finance or the theft of wallets.

THE FINANCIAL SECTOR HAS NOT YET REACHED THE 'HOLY GRAIL' OF CONVERGENCE BETWEEN SUSTAINABILITY AND DIGITALISATION.

By the same token, the financial sector has not yet reached the 'Holy Grail' of convergence between sustainability and digitalisation. Respondents to the *WealthBriefing* survey did not even know how the two might converge – except one, who wrote: "They must converge eventually if they are to be used more freely to support Environmental, Social and Governance ("ESG")/impact projects or to allow more open markets across the globe in terms of transfer of funds to far-reaching locations where these projects need financial support…but only post some deeper levels of regulation being applied to the digital asset classes."

When asked to identify the types of digital asset for which they found it hardest to produce high-quality reporting for clients, half the respondents noted that their clients had no assets to report or thought that the question did not apply to them. One stated that he merely used an external company to provide asset-consolidated reporting for all asset types and groups, either through an app or in soft-copy PDF versions. When asked about the part that Artificial Intelligence ("AI") played in client reporting, the respondents' replies were similarly dismissive.

Brockhurst, meanwhile, noted that proof-of-work or PoW, a form of cryptographic proof practised by Bitcoin in which one party (the prover) proves to others (the verifiers) that a certain amount of a specific computational effort has been expended, was wasteful in energy. By contrast, proof-of-stake, a crypto-currency consensus mechanism by which the Ethereum network processes transactions and creates new blocks in a blockchain, is much more efficient. Ethereum – a very important operator in digital assets – advertises itself as a green blockchain.

Brockhurst also revealed that some of his clients had struggled to raise funds for projects, especially mining projects, on account of ESG-related issues.

"The investment banks won't look at it for ESG reasons – not because it's crypto, but for ESG reasons. A lot of the digital-asset clients I deal with… not many of them have a particular sympathy for ESG issues – no more than in any other sector. There are greener crypto-protocols out there, but I think also that trust companies probably need to look at their policies and protocols, to decide if there are certain types of digital assets that they won't take into structures for that ESG reason. Ethereum converting to proof-of-stake is a positive step, so I'm optimistic that the two can be interwoven and that trust companies and private banks will force the hand of miners and other players in the market to 'up' their ESG credentials."

WealthBriefing's survey of its global contacts revealed that they had not run into any conflicts between ESG-related considerations and digital assets. One spoke for many by saying: "As they are very small allocations, it has not been a big concern".

ESG/IMPACT INVESTING IS HIGH ON THEIR LIST OF PREFERRED HOLDINGS, EVEN IF THEY DO NOT PRODUCE AS MUCH YIELD AS TRADITIONAL INVESTMENTS.

Despite this, a large proportion of their clients were interested in ESG as an objective, with the figure sometimes reaching 75 per cent. Younger clients and beneficiaries – especially in the UK and Europe – were particularly interested. One wealth manager commented: "ESG/impact investing is high on their list of preferred holdings, even if they do not produce as much yield as traditional investments. Currently circa 14 per cent of our total AuM is investments in ESG/impact projects".

The ages of the wealth manager's investors/beneficiaries who were interested in ESG lay almost always between 20 and 40 years, with gender being split equally. These youngsters tended to be attached to family businesses or family offices which they stood to inherit eventually through trust structures. For other wealth managers, the figures were lower and the under-40s who were showing an interest were predominantly female.

Artificial intelligence

The panel turned to the subject of AI and its relevance to digital assets. AI helps financial firms replicate and gather data at a much faster speed than previously. Heather-Anne Hubbell, with Brockhurst in agreement, pointed out that digital assets often require a very bespoke type of reporting and that AI could help the process along.

TO WHAT EXTENT DO DIGITAL ASSETS ENHANCE TRUST, OR DO THEY DO THE OPPOSITE?

"One of the things you can use AI for is to grab that information, pull it together, assess it and create some more of a standardised reporting. That's quite helpful because it gives access to the immediacy that investors are looking for.

"It aids personal service for your clients and security because it can go and find the information, bring it together and create a report which you can then review and take to your clients very quickly. Rather than spending your time doing labour-intensive individual activities, you can use the AI capability to do that and free up capacity to add the personal value. We can meet people's desire for immediate responses but without losing the quality of the information. Not only are we able to deliver it easier but we are able to reduce the operational risk in the process. We give you better service but actually it's better quality too, because we've leveraged technology.

"That's what technology is about. Digitisation is freeing up capacity for us to do the really useful and important things while we use the machines to do the activity which is labour-intensive and not necessarily viewed as value-added until you get the output and can assess it and discuss it with the clients."

Can digital assets make customers more trusting?

Stephen Harris reminded the panel that trust forms the basis of the private-client relationship and asked the question: to what extent do digital assets enhance trust, or do they do the opposite? The members of the panel, however, were more interested in talking about digitalisation in general. They agreed that HNW clients wanted enhanced digitalisation and AI because it added value in relation to onboarding and created more opportunities for transparency and live-time reporting.

HNW CLIENTS WANTED ENHANCED DIGITALISATION AND AI BECAUSE IT ADDED VALUE IN RELATION TO ONBOARDING.

Naomi Rive spoke for all when she said: "I think clients are sick to death, probably, of providing everybody with their passport and utility bill and we should now be able to get to a common acceptable standard in relation to requirements such as that and make it a much easier and slicker process for clients."

The panel also noted that the COVID-19 pandemic had propelled the industry forward in this area and that many businesses had moved on to electronic signing. Rive said that her clients had embraced Zoom and that her firm used WhatsApp and Signal to communicate with them. This cut down on flight time and time spent on physical meetings, which itself was good for sustainability, but she thought that digitalisation could only go so far.

FACE-TO-FACE RELATIONSHIPS ARE STILL AT THE HEART OF WHAT WE DO.

"I do think that face-to-face relationships are still at the heart of what we do. Ultimately, before you take on a new relationship or on an annual basis, clients will still want to see you face-to-face and I think that that's very much one of the unique selling points of our sector."

Heather-Anne Hubbell did not believe that technology would ever overtake human interactions in the private-client sphere.

"You really don't get the full nuance of what people are looking for and how they want to move forward in simply the technology side. It really is great for those regular activities like onboarding and the key is to get all parties across the infrastructure, across the ecosystem, to embrace technology at the same level... but that is only to enable us to do the repetitive tasks and the things which we need to do quite regularly.

"We still are always going to need that personal touch to understand exactly what drives people and deal with changes in circumstances or the impact of events. You really must have a much better conversation with the client to understand how they feel about it in a way that is just not possible through the technology."

Most members of *WealthBriefing's* editorial board said that they were not using AI in the onboarding process, although some were looking forward to doing so. One described it enthusiastically as a game changer for the fiduciary services of the future.

Digitalisation and the legal profession

Nobody on the panel thought that technology could replace the relationship that a lawyer has with his UHNW clients. James Brockhurst was prepared to envisage AI being used to review the viability of a judgment, or an AI platform assessing someone's domicile, but did not think that computers could replicate the job of a trusted advisor easily.

THE FINANCIAL CRISIS OF 2008 ERODED CLIENTS' TRUST IN INTERMEDIARIES.

"The number of back-and-forths that go into the creation of a trust document... one unsubtle word changing could have a significant impact on the whole deed, so that level of psychological and emotional intelligence that lawyers in IFCs drafting these documents need is critical. So, from a review perspective, yes. From a creation and trusted-advisor perspective, no, although obviously the industry is trying to challenge this."

Brockhurst also noted that the global financial crisis that began in 2008 had eroded clients' trust in intermediaries considerably and thought that this was prompting them to turn to technology in an interesting way.

"I've got clients who, when they say 'what happens when I die' and I explain the concept of an executor, they would say 'no thanks, I would rather transfer my assets into a smart contract that… informed of my death, when it happens, and then my assets default to my children's wallets, because they don't trust intermediaries'. So, actually, there is still a lot of work to do to earn their trust. Trust is what we need to sell and technology is trying to offer alternative solutions to (bolster) that trust."

Regulation for trust companies

Brockhurst ended with a point about regulators: "I think I'd like to see the regulators in IFCs around the world supporting trust companies to a larger degree. I feel that trust companies feel they have to make decisions alone. I don't think there's any consensus on issues such as custody. Should you let the client self-custody, as some companies are doing, or should you outsource to a properly-regulated custodian? I think that trust companies are going to need that support.

"This wealth in digital assets is enormous and needs to be structured. Otherwise, there are going to be all sorts of disputes and assets lost. It'll be an absolute nightmare. So the trust companies need support to move along in this process and I hope the regulators will be sympathetic and helpful to them in that process."

What the industry wants to see next

WealthBriefing asked its contacts the following questions: "What is the one part of the private-client world where you would like to see greater digital integration, and why? Also, what kind of digitalisation would you like to see, and why?"

Some respondents pointed to payments; others to compliance, which they thought was unnecessarily complex and wasteful in view of the different approaches that jurisdictions and various types of financial institution take. One commentator thought that a common approach through a one-stop know-your-customer process would be useful and could be digitalised.

Another wrote: "Digital integration is critical for ESG/impact investment projects but while regulation around digital assets remains weak or non-existent, then this will slow down the impact that these projects can have on a sustainable world going forward. Family offices and private clients in the HNW/UHNW arena want to invest in these asset classes but fear without regulation that the risk is far too high."

A trust expert wrote: "Smart contracts will be inevitable and impactful, but we have not seen them in use yet. I suspect that this will be soon, and with rapid adoption once well-established protocols are in place."

SMART CONTRACTS WILL BE INEVITABLE AND IMPACTFUL.

Stephen Harris asked the panel at one point whether fractional ownership – the splitting of the cost of a piece of property among a group of owners – was a major factor in the world of digital assets. Nobody came forth with a real opinion, but one commentator from the *WealthBriefing* universe proved that it was at least a noticeable factor, stating that the only questions that clients asked him about digital assets involved the fractional ownership of collectibles.


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