UPDATE

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# Cryptocurrency: Private Clients and their crypto investments

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This update considers succession planning and control challenges by investors to ensure all of their investments are kept equally safe and are passed on effectively and in accordance with their wishes.

This update forms part of our series on cryptocurrency. Our previous article, an overview of distributed ledger technologies can be found here.

## The rise in interest in digital assets

Since the introduction of blockchain and distributed ledger technology over a decade ago, digital assets, including cryptocurrency, have become an increasingly attractive asset class to investors. Like private equity and venture capital before it, some clients are nervous of the higher risk, while others have embraced the risk for an opportunity for greater reward. With the evolution of the sector, and the technology that supports it, digital assets are now starting to form part of the conventional investment conversation for sophisticated high-net-worth investors and their family offices. This in turn has presented succession planning and control challenges that must be considered by investors to ensure all of their investments are kept equally safe and are passed on effectively and in accordance with their wishes.

## Wealth planning and digital assets

Increased sophistication of wealthy families coupled with the emergence of younger family members who have an appetite for new and tech based asset classes and who now hold influence over the investment direction of the family have fuelled interest in digital assets. In keeping up with this trend, the trick for trust and estate practitioners has been finding ways to bridge the gap between digital and traditional assets so that wealth plans effectively deal with both and continue to offer protection for the benefit of their client.

There has been much debate in recent years about whether digital assets are capable of ownership sufficient for them to be held by a trustee as part of a trust's assets. Various Commonwealth courts including the England and Wales High Court and the New Zealand High Court have been asked to rule on this question and have found that digital assets, including cryptocurrency, constitute property that is capable of being held in a trust structure.

Depending on the nature of the digital asset, there will be various administrative considerations that require thought, such as how the asset is effectively owned and held. For example, cryptocurrency is owned and traced through a "wallet" and access to this is via a public and private key, which unlocks an owner's right to access and transfer coins or transact. Once lost there is no helpline or security questions to help you reset your key and access your investment. Safe custody of the private key is therefore an important consideration not just during a person's lifetime but also in terms of protecting the asset in the event of a loss of capacity or death of the investor and in some cases the wallet holder, or key holder. Following the loss of access to over CAN$250m of investments on the death of QuadrigaCX's CEO in 2019, who was the key holder of its investors, lessons had to be learnt.

Trusts and foundations offer asset protection by enabling the separation of legal ownership from the beneficial use and enjoyment of assets, in the same way that a family investment company can. Their enduring nature means they have to address succession issues in a way that individuals do not always do.

Depending on the jurisdiction/country, such protection can also include:

1. Avoidance of probate processes and consequential court fees.
2. Tax benefits (keeping future growth outside of an estate and therefore reducing inheritance tax).
3. An ability to set specific rules and parameters for the use of assets.
4. Protection for beneficiaries in generations to come.

Digital assets, much like traditional assets such as cash and real estate, are exposed to the same sorts of risks. The use of structures to hold digital assets provides wealthy families with the ability to set out how they want these assets to be held and administered in the future. It also forces them to address how best to protect access to those digital assets from the outset.

The benefits these structures provide must be balanced against the increased risks the corporate service provider faces in holding higher risk assets for the benefit of others. Cryptocurrency is volatile and currently under-regulated compared to most asset classes. Digital assets are also mostly uninsurable and these risks need to be carefully considered when setting up the structure.

For example, thought should be given to diversification and what proportion of the trust fund is represented by digital assets and how these assets are to be administered by the trustee. As a fiduciary, the trustee is subject to various obligations such as preserving and, in some cases, maximising the value of the trust fund.

### Dealing with digital assets on separation or divorce

Depending on the type of digital asset held it is likely that they will be more volatile than other asset classes. As a result, their valuation can change greatly in the run up to any financial separation meeting and this can add complexity and expense to any financial negotiations. With a trust it may be that this removes that asset class from the discussion to a certain degree.

### Dealing with digital assets on loss of capacity or death

The same complexity and expense could also arise for the Executors following a death. If, for example, an estate held a digital asset portfolio and a large home of equal value, to be shared equally between two children (one taking each) then the home is likely to be a fairly stable valuation but the portfolio value may vary greatly during negotiations and indeed nullify certain planning if the change is significant. As the executors are personally liable it is important to ensure the terms of the Will are properly adhered to and the division is equal, at least at the point of division. Where part of the estate is subject to civil or religious law and passes automatically on death with another part being subject to the terms of the deceased's Will this could add a further layer of complexity.

### Managing digital assets which are held personally

There are a number of operational risks associated with managing and maintaining digital assets. Chief among these is ensuring that the owner's private key is safe and secure. These challenges need to be considered from a control and a succession planning perspective. If there are digital assets that are held personally, the attorney may need to access the investment on loss of capacity, and on death the executor or administrator will need to obtain legal title to the assets so that they can transfer them to the rightful heir, either under a Will or in accordance with the law.

Once access is lost it is final so it is important to plan for the passing of digital assets. In addition it is important to ensure that each digital asset is appropriately identified. It is common for a digital inventory to be created and stored with the Will, for the executor's attention. This inventory might include details of each digital asset and online account (ie public key) and explain how private keys can be accessed or how they are held. Thought has to be given to who the owner trusts to have access to the wallet and keys. It might be that parts of the private key are shared between trusted individuals who must work together on such an event to access and manage the investment. This allows for them to self-govern each other's actions.

### Regulation

Digital assets exist within blockchains which are borderless, whereas regulatory bodies operate within a specific jurisdiction. This is something that wealthy families and trustee's alike need to consider when planning how to structure digital assets such as cryptocurrency. Although there are some jurisdictions that have now introduced regulation and legislation that gives legal recognition to digital currencies and provides standards for asset managers, this is still evolving.

## Important tips for those dealing with digital assets

For individuals:

1. Consider who you trust to control unregulated but potentially high value digital assets you own.
2. Consider what safety mechanisms you find offer an acceptable level of accessibility and protection.
3. Consider who should hold your private key, when and how.
4. Consider putting in place lasting powers of attorney and a Will to specifically address succession.
5. Review any planning you have every few years as this is a fast passed world of innovation.

For those managing structures which hold crypto:

1. Understand the nature of your obligation (personal or fiduciary powers) and the level of protection the structure gives you).
2. Understand how digital assets are acquired (and the compliance needed) and held;
3. Develop internal protocols for the safekeeping of public and private keys and/or wallets;
4. Understand the nature of the asset class and review the investment at agreed intervals;
5. Understand the original investor's appetite for risk when setting up the structure;
6. Ensure that the investment and the asset holder are appropriately insured (i.e. insurance coverage extends to the management of digital assets); and
7. Understand the mechanics of how digital assets can be distributed to beneficiaries.
8. Review your structure if there is a change in circumstances (change of law, taxation of digital assets or the settlor/beneficiaries move to a new country).

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