CRYPTOCURRENCIES

The crypto factor

Will wealth managers learn to love bitcoin and its ilk, or will the associated volatility risks and lack of regulation remain a deterrent for all but the boldest players?

Jon Yarker

The surging popularity of cryptocurrencies and digital assets in general has caused consternation as well as excitement. In June, the Financial Conduct Authority (FCA) estimated that 2.3 million adults in the UK were holding crypto assets – up from 1.9 million only 12 months previously. This prompted the regulator to warn investors that they should "be prepared to lose all their money".

The suitability of these assets for ordinary retail investors has been fiercely debated, but what of the super-rich, who possess enough capital to accommodate high-risk investments safely?

The UK wealth management industry has yet to engage fully with cryptocurrencies. Many of the nation's most established players have steered well clear of investing in them so far.

Charles Stanley Direct is one of them. The firm's chief analyst, Rob Morgan, says: "We don't consider crypto assets investable at present."

But he adds that the buzz being generated by crypto investments means that the subject is coming up more in discussions with clients. "We can't ignore the subject. It receives a huge amount of attention from the public and the media, so we have to hold open and honest conversations about what it is and the risks it poses."

Tilney Smith & Williamson is another big wealth manager that has yet to get involved. Its MD of corporate affairs, Jason Hollands, explains that crypto investments are difficult for the firm to consider because the asset class is still at a "nascent" stage.

"When constructing portfolios for their clients, most wealth managers are highly focused on the risk/reward balance," he says. "This can be especially true in the case of ultra-high-net-worth clients, whose objectives often include preserving the capital that they've built up over time. They can actually be less inclined than most to take unnecessary risks."

Other wealth managers are unwilling to discuss the subject with their clients. One of these is Rick Eling, investment director at Quilter Financial Planning, who describes crypto as "fool's gold".

Such investments "should be considered more akin to gambling", he adds. "Their volatile nature means that you should be prepared to lose everything. Cryptocurrencies are simply not a legitimate alternative to real investments."

Traditional investment choices are based on evidence-based assessments of a given asset's value-creating potential. For example, a wealth manager may decide to buy shares in a company because it is consistently making big profits. Hollands says that the highly speculative nature of digital assets makes this a very different scenario for portfolio management.

"They generate no yield and it is questionable whether they have any intrinsic value," he says. "Cynics might describe crypto investment as a classic example of 'greater fool theory'. That is, to know whether the price of an asset is low, fair or expensive in the absence of fundamental valuation measures, you simply invest in the hope that the next buyer is willing to pay more than you have paid."

Despite such arguments, a number of financial institutions have been exploring how they might capitalise on the attention that cryptocurrencies are attracting. They include WisdomTree Investments, which is offering crypto-based exchange-traded funds and products.

The company's director of digital assets, Benjamin Dean, accepts why wealth managers would want to steer clear of cryptocurrencies. But he argues that, with the right mix of assets, an appropriately sized crypto allocation can increase a portfolio's Sharpe ratio – an indication of how well an asset's returns compensate for the level of risk they oblige the investor to take on.

"Our analysis has indicated that making a 2% allocation to bitcoin in a sample global 60:40 equity/bond portfolio would have resulted in a 0.5 percentage-point increase in portfolio volatility during our period of study, from 9.0% to 9.5%, while delivering a return of 9.4% compared with 7.1% for a 60:40 portfolio not featuring bitcoin," Dean says. "In effect, adding bitcoin improved the portfolio's Sharpe ratio from 0.71 to 0.94. To give some perspective to those figures, the MSCI All-Country World Index returned 10.1% with 13.7% volatility – equating to a Sharpe ratio of only 0.68 – in the same period."

But it's the continued lack of regulation that remains the main reason why many wealth managers feel that they can't seriously consider crypto investments, despite the huge reserves and appetite for risk that some of their ultra-high-net-worth clients will undoubtedly possess.

"Providers of professional indemnity insurance are wary when it comes to cryptocurrencies. Very few of them are willing to underwrite crypto risks, which presents a challenge for wealth managers seeking cover," says John Greene, divisional director at Howden Insurance Brokers. "The professional indemnity market is already challenged, with businesses facing higher rates and coverage restrictions, so they are probably choosing to avoid introducing extra non-essential risks such as crypto."

The legal minefield surrounding crypto cannot be ignored, observes Kate Troup, a partner and specialist in financial services regulation at law firm Fladgate.

"It's important for wealth managers to know that the FCA doesn't want investors to be confused about whether or not a service offered by a regulated firm is covered by regulatory protections," she says. "If managers do want to provide advice or management services for crypto assets, this must be managed carefully from a compliance perspective. To protect their reputations, they will need to consider whether they have the appropriate in-house expertise to ensure that they can offer a similar level of service to that which they provide for traditional investments."

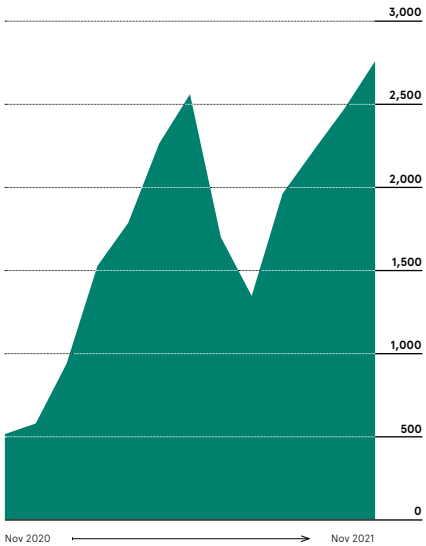
For these reasons, many wealth managers are fighting shy of cryptocurrencies, notes Eling, who argues that there's no point in allocating such assets for his clients until better safeguards are available.

"We are likely to see a devastating collapse in the crypto market one day," he predicts. "And I would not wish for our clients to be among the casualties."

THE RISE OF CRYPTOCURRENCIES

Statista, 2021

Total cryptocurrency market capitalisation ($bn)



Commercial feature

Helping clients build sustainable legacies by being a responsible bank

As Kleinwort Hambros' CEO **Mouhammed Chouker** explains, there is an increasing desire to understand the impact of our actions on the climate and society as a whole

By helping clients build sustainable legacies, we enable them to achieve their long-term, intergenerational goals.

In order to do this, as a leading responsible bank, first you need to walk the talk. That means proving, through your actions, that responsibility runs through every part of your business.

At Kleinwort Hambros we focus on the four key 'Cs': clients, colleagues, community and climate. We help our clients to build sustainable legacies; we support our colleagues by promoting diversity and inclusion (D&I); we make a positive social impact for our community and we champion climate action by reducing our carbon footprint.

Moving the dial on all of these factors in a meaningful way enables us to become a leading responsible bank.

As a wealth manager and private bank, our clients are at the heart of everything we do. By helping them build sustainable legacies, it enables them to achieve their long-term, intergenerational goals.

But, increasingly, clients are becoming more aware of the impact of their investments on the environment and wider society.

Data from the Investment Association shows that UK savers have put almost £1bn a month on average into responsible investment funds during 2020. Added to that, a recent study by American Century Investments has found that 64% of UK millennial investors are interested in impact investing.

We are focused on optimising the positive impact of our clients' investments and minimising or eliminating the negative impact. To assist them, we give clients all the information they need to make informed decisions to achieve these goals.

We want to be as transparent as possible with our clients to ensure they receive the information they need about their investments and understand the impact they're making beyond their immediate financial objectives.

> **Clients are becoming more aware of the impact of their investments on the environment and wider society**

74%

of millennials believe their workplaces will have greater innovation if management actively makes diversity and inclusion a key component of organisational culture

20%

of executive committee roles in major UK financial services firms are held by women

Oliver Wyman, Women in the Financial Services

64%

of UK millennial investors are interested in impact investing

American Century Investments

Acceleration of change

The Covid-19 pandemic has accelerated this move towards becoming a more sustainable and responsible organisation. This is achieved, in large part, by establishing and maintaining a diverse and inclusive workplace.

That means creating an environment where everyone feels included as part of the same team, regardless of gender, ethnicity or culture.

As millennials and Gen-Z are fast becoming the dominant generations in the workforce, according to the 2018 Deloitte Millennial Survey, 74% of respondents said they believe their workplaces will have greater innovation if management actively makes diversity and inclusion a key component of organisational culture.

Kleinwort Hambros is a diverse organisation, gender-balanced, and has people from all different backgrounds and walks of life, from the top down. But inclusiveness is only truly achieved by having open conversations about how people feel, listening to what they have to say, and addressing their views and concerns.

The pandemic has also required employers to be more empathetic towards their staff and take genuine care of their wellbeing.

We spent a lot of time in 2020 listening to each other about our personal circumstances and the need to achieve a proper work/life balance. Those conversations have been very powerful for us in terms of our inclusivity and have helped us to create a healthier workplace culture too.

Listening organisation

The focus now for Kleinwort Hambros is very much on the inclusion part of D&I. As a result, we have set up a dedicated Culture and Conduct network and Gender Equality Forum to make sure that everyone's voice is heard.

The big strides we have already made in establishing a diverse workforce and an inclusive workplace culture are reflected in the fact we were named as one of London's top 75 Best Large Companies to Work For in 2021 by *The Sunday Times* and were the only private bank to be listed.

The finance industry is also moving forward with the recognition of the need for a more balanced and inclusive culture. As part of this, the WealthiHer network champions the transformation of the wealth management industry's approach to female investors, and we are proud to be a founding member.

It's crucial, however, that any progress made is measured against clearly defined targets. As a signatory of the Women in Finance Charter, as part of the SG Group, we have already achieved its target to increase representation of women in senior roles by 25% across our UK platform by 2022.

We also have one of the smallest gender pay gaps in UK private wealth management and a diverse executive committee.

Our work on diversity extends to developing young talent through apprenticeship and internship schemes, as well as a next-generation executive committee of analysts and associates who work on strategic projects to gain a greater oversight of the business.

But the wealth management industry can and needs to do more to improve access for people from less privileged backgrounds. That's reflected in the fact that almost 90% of senior roles in financial services are held by those from higher socio-economic backgrounds, according to the Diversity Project.

Our role is to embrace and encourage social mobility by supporting charities like The Brilliant Club, which works with schools and universities to support students who are less advantaged to access the most competitive universities.

Mirroring diversity

Our diversity is mirrored in our client base too, which is from a host of backgrounds and has a wide range of requirements. By having a diverse workforce, we can provide our clients with the best team that understands their needs and background, to work with them to achieve their goals.

By having different views, you can have productive conversations and work together to find the best solution. As an end result, you can help your clients to build the sustainable legacy they want to achieve.

A diverse workforce that is representative of both wider society and a changing client base is essential to the drive innovation, performance and best client service and expertise.

A responsible bank with a diverse and inclusive workplace, understands these needs and can help clients build sustainable legacies.

For more information about how Kleinwort Hambros can help you to build a legacy, please visit kleinworthambros.com

KLEINWORT HAMBROS

SOCIETE GENERALE GROUP