

BYALLACCOUNTS® • WHITE PAPER

Cryptoasset Clarity

Why Your Advisors Need to Know All About Clients' Crypto Portfolios

Your advisors don't have to advise clients on cryptoasset investments. They do not have to approve of cryptoasset investments or recommend them. Few firms or advisors do.

But your advisors do need to know what their clients have invested in cryptoassets and understand the implications of investments, because many clients have already made them. Invested cryptoassets make up a large enough portion of many clients' self-directed portfolios, so financial advisors need to understand their impact on client retirement, risk, estate, and tax planning.

In addition, as of Jan. 1, 2024, knowing about your clients' cryptoassets will help them comply with the law. A new provision of the tax code requires anyone who receives \$10,000 or more in cryptocurrency in the course of their trade or business to report details of the transaction to the IRS.

In this white paper, we'll cover the basic reasons why advisors, as a fiduciary, must understand their clients' cryptoasset investments regardless of their views on cryptoassets. This includes the considerations advisors should discuss with clients regarding the implications of their cryptoasset investments and the tools that you can offer your advisors to gain visibility into those assets.



Understanding Cryptoassets in Modern Financial Planning

The financial landscape is experiencing a change in basic assumptions, with cryptoassets rapidly emerging as pivotal elements in contemporary investment strategies. For financial advisors, an in-depth understanding of cryptoassets is no longer optional but essential for effective portfolio management, tax planning, and estate planning. This trend transcends any simple fad; it's a profound and enduring change in the way individuals invest, especially as regulators increasingly approve cryptoasset investment vehicles.

Portfolio Planning

Research over the past two years shows that cryptoasset investment is gaining mainstream traction among both institutional and high-net-worth investors.

With an ongoing and substantial intergenerational wealth transfer from baby boomers to millennials and Gen Z, it's crucial for advisors to acknowledge the rising prominence of cryptoassets. This transfer encompasses not just traditional assets like stocks and bonds but also increasingly includes cryptocurrencies and nonfungible tokens (NFTs).








Advisors overlooking this evolution risk being left behind in the eyes of a new generation of investors who perceive cryptoassets as integral to their investment portfolios. They also run a genuine risk of leaving fees on the table and not fulfilling their fiduciary responsibilities by ignoring a growing portion of client assets.

"They need to learn about it because there's a huge number of retail investors that have significant money in crypto," said Matt Hougan, CIO of Bitwise Asset Management, in a talk for the CFA Institute Research & Policy Center. "They're going to ask you questions. Maybe you don't think crypto is appropriate, and maybe you think it is. But you need good answers."

And those questions are increasingly inevitable. According to a 2023 Bitwise/VettaFi Benchmark Survey, some 90% of financial advisors received a question about crypto from clients last year:

What percentage of clients have asked questions about crypto in the past 12 months?



	% of Advisors	% of Clients
	10%	0%
	33%	0.01%–4.99%
	21%	5%–9.99%
	17%	10%–19.99%
	12%	20%–49.99%
	5%	50%–99.99%
	1%	100%

Indeed, in spite of the major fraud-related crashes in 2022 following the fall of FTX, the North American crypto market remains the largest individual cryptocurrency market globally, with an estimated \$1.2 trillion in value received on-chain between July 2022–June 2023, according to a 2023 Chainalysis study on the geography of cryptocurrency.

Those scandals had little measurable impact on estimated activity, particularly among retail and sub-institutional investors. Growth in the value of bitcoin and ethereum toward the end of 2023 is also expected to increase investor interest in cryptoassets. Bitcoin's value grew more than 160% in 2023, while ethereum prices increased more than 80%, according to data from YCharts. Investor interest generally increases with prices. Interest is likely to be heightened with the U.S. Securities and Exchange Commission's (SEC) approval of a bitcoin ETF in January 2024.

Given that continuing appetite, risk management is key, and it takes on a new dimension with cryptoassets. Advisors must consider unique risks, including technology and protocol vulnerabilities, to assess and manage the overall risk of a client's portfolio. Understanding the location and liquidity of cryptoassets is crucial, as these factors significantly impact investment strategies.

Access to real-time data on client crypto wallets is especially useful in managing a total risk picture. Armed with that data, advisors can point out overall asset allocations on a risk basis, including the percentage of assets in high-risk and high-volatility vehicles. Advisors will also know when to ask clients about events that heighten risk, such as the FTX debacle, crypto hacks, or potential regulatory actions.

Above all, lack of up-to-date information can open fundamental problems for a portfolio, particularly as these assets remain volatile and, critically, are not as well protected as other classes of assets. As a 2023 brief from the SEC notes: "No cryptoasset entity is registered with the SEC as a national securities exchange (like, for example, the New York Stock Exchange or the Nasdaq Stock Market). And no existing national securities exchange currently trades cryptoasset securities. As a result, investors in cryptoasset securities may not benefit from rules that protect against fraud, manipulation, front-running, wash sales, and other misconduct when intermediaries for those products do not comply with the federal securities laws that apply to registered exchanges."

Diligence and visibility into crypto investments are critical for investors with an eye toward risk. That visibility can only come from reliable data, just as it does for traditional investments.

Tax Planning

Precise cryptoasset data is required for adequate tax planning. With newly proposed regulations, advisors with precise and up-to-date data can guide clients in fulfilling their tax obligations, ensuring compliance. For one, IRS figures show that only 842,888 taxpayers reported crypto in 2021, far below the number who own it. Realized and unrealized gain and loss data on cryptoassets have client tax implications that most advisors are not considering.

In addition, the IRS requires all taxpayers to respond to this question regarding cryptoasset-related income: "At any time during 2023, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)?" The IRS added the question in 2022 to many tax forms beyond 1040, including others in the 1040 series, corporate returns in the 1120 series, returns for estates and trust, and partnerships.

The IRS treats cryptocurrencies as property for tax purposes, so advisors need to guide their clients on the tax implications of their crypto transactions. Accurate data on realized and unrealized gains and losses can help advisors provide effective tax planning advice, including conversions of cryptoassets into fiat currencies.

As more taxpayers hold cryptoassets in their portfolios, charitable organizations are beginning to accept gifts of cryptoassets. Advisors can guide their clients through the process of making charitable contributions using cryptoassets, ensuring they maximize their tax benefits.

Amendments introduced in the Infrastructure Investment and Jobs Act are significant for cryptoasset reporting and taxation. They clarify the definition of a broker for cryptoasset transactions and expand the rules for reporting cryptoasset transactions. This includes cryptoassets as specified securities and the application of these rules to covered securities acquired after a specific date.

Provisions Include:

Tax Treatment of Virtual Currency: The IRS classifies convertible virtual currency as property for federal income tax purposes. Convertible virtual currencies are those with an equivalent value in real currency or that function as a substitute for real currency. The advisor's role is to help remind their clients to report any holdings and transactions with these assets.

Cryptoasset Wallets and Transactions: The proposal distinguishes between distinct types of wallets (custodial and noncustodial) and their functionalities. If an advisor has discretion over a client's assets, that is considered custody and requires a qualified custodian.

Transactions Involving Cryptoassets: The proposal also covers the use of cryptoassets in various transactions, including payments for goods and services, real estate purchases, and derivative transactions.

Investment Reporting: The proposed Form 1099-DA will update reporting requirements under different sections of the IRS code, such as sections 6041, 6045, 6045A, and 6045B, with aspects like the reporting of gross proceeds, adjusted basis, and other relevant information for transactions. Advisors must help educate their clients to ensure they report their investments and track gains and losses properly.

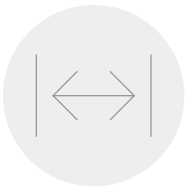
Advisors must be aware of these diverse uses to effectively incorporate cryptoassets into their clients' financial planning and risk assessments. The following questions are vital for any client who may have tax exposure in this area:

- What types of cryptoassets do you own?
- Where are they held?
- What is their total value?
- How many trades have you made?
- Have these been reported to the IRS?
- Do you have any relevant tax statements?
- Were any held on platforms that went bankrupt?
- Have you experienced theft via hacking?
- Have you been paid in crypto for work or services?

Estate Planning

The rise in cryptoasset ownership also has estate planning implications. Advisors can assist clients in creating comprehensive estate plans that ensure the smooth transition of cryptoassets to their designated heirs. When an advisor knows clients have crypto investments through good data, they can ask all relevant estate planning questions.

Advisors must navigate challenges posed by the lack of traditional estate planning tools in the crypto world. Many crypto accounts don't offer standard beneficiary designations, requiring new approaches to ensure these assets are correctly accounted for and transferred according to the client's wishes. There are also definite technical considerations clients must be aware of. For example, the private keys that protect crypto wallets must be made accessible to heirs.



Investment Advisors' Cryptoasset Visibility Gap

Even though the cryptoasset domain is growing, a conspicuous visibility gap persists among investment advisors. Various surveys indicate an uptrend in U.S. cryptocurrency ownership: 10% in a 2022 Federal Reserve Board survey; up to as much as 20% according to Coinbase's own numbers. But this interest isn't mirrored in the current expertise of many financial advisors.

And that's a problem: With over 110 million accounts on the Coinbase exchange and an average account balance of \$870, the math is simple. Many of today's clients have a cryptoasset account.

"We're at the point of reaching mass acceptance before mass adoption when it comes to cryptoasset investing," said Tyrone V. Ross Jr., CEO Turnqey Labs, in a 2023 interview with fintech company SmartAsset, "which basically means that we know that cryptoassets are not going away."

Fundamentally, it seems that many are still having difficulty understanding crypto investments and their implications for financial planning and risk management. Most advisors cannot view client investments in cryptoassets, as access to investment wallets and data has traditionally been inefficient. Unlike traditional asset classes, visibility into cryptoassets generally depends on client initiative. This leaves many advisors ill-prepared to offer comprehensive advice that considers their clients' investments in cryptoassets.

Advisors must become equipped to help navigate their clients through the impact of cryptoasset investments in all areas of their clients' finances, regardless of whether an advisor endorses or recommends cryptoassets as an investment portfolio option.

For financial advisors, this signals a changing investment landscape, highlighting a broader trend of digital innovation in finance. Financial advisors must be prepared to address questions and potential interests from retail clients regarding these evolving investment opportunities. Again, knowledge and visibility of cryptoassets in client portfolios are important to understand and consider in all areas of a client's complete financial picture.



How Crypto Visibility Helps Your Advisors Serve Their Clients

Access to current and accurate data is paramount for your firm's financial advisors to guide clients with crypto investments. The complexity and rapid-fire pace of the crypto market necessitate a comprehensive understanding of these assets and how they interplay with the traditional assets advisors currently track.

Solving the cryptoasset information gap will necessitate sources that can manage real-time data aggregation, enabling advisors to obtain the most current information on cryptoasset values, transactions, and market movements. Real-time data is crucial for informed decision-making regarding portfolio allocations, risk management, and potential tax implications.

It's also good for an advisor's business. Those who can find a way to bridge that gap stand to find a lot of new business. In a 2023 Bitwise/VettaFi Benchmark Survey, 59% of financial advisors reported that either "some" or "all" of their clients are simply investing in crypto on their own, outside of the relationship with their financial advisors:

Do your clients invest in crypto on their own?

	2020 Survey	2021 Survey	2022 Survey	2023 Survey
Yes: All of Them	1%	2%	6%	14%
Yes: Some of Them	34%	34%	62%	45%
Don't Know	37%	38%	19%	24%
No	27%	26%	14%	17%

This pattern not only increases exposure and risk for investors; it simply leaves a satellite of their overall investments off the table when it comes to portfolio planning, which leads to an incomplete picture of assets.



ByAllAccounts: Bridging the Data Gap With a Comprehensive Wealth Data Aggregation Solution

It's a simple necessity: financial advisors will need to have visibility into their clients' crypto investments. With a significant segment of the population owning cryptocurrencies, advisors who disregard these assets risk overlooking a critical component of their clients' financial portfolios.

ByAllAccounts offers a robust solution for real-time wealth data aggregation, including cryptoassets. This service allows clients to connect to top crypto exchanges, such as Coinbase and Gemini, and securely share the data with their advisors, providing them with a holistic view of their clients' cryptoasset holdings. ByAllAccounts' capability to deliver daily or real-time API connectivity positions it as an invaluable tool for your organization to offer advisors who are seeking to integrate the visibility of the client's cryptoassets into their financial planning and advisory services.

The primary value rests on ByAllAccounts' reputation for timely, accurate data from credible sources. The ability and confidence to aggregate cryptoasset data had been difficult to find.

That confidence and clarity also comes with some simplicity. Many individual investors have bits of assets held in a diffuse way, sometimes across multiple wallets or across multiple currencies that in no way connect. ByAllAccounts aggregation of crypto exchanges centralizes all that information.


This process entails collating data from various crypto exchanges and wallets to provide a complete view of a client's crypto holdings. By leveraging ByAllAccounts, your advisors can access this aggregated data, enabling them to make more informed decisions and provide superior advice to their clients.

This premium data offering, enables wealth management firms and wealth technology platforms to provide advisors with more visibility into held-away cryptoassets so they can:

- View assets held on exchanges and custodial platforms for asset allocation and financial planning purposes.
- Reconcile custodial and noncustodial data into a single data set.
- View all transactions and transfers made by individual wallets.
- Understand cryptoassets for tax planning.
- Know the location of cryptoassets to assess the exchange or wallet risk; liquidity data on how long positions may be locked (i.e., staking).
- Create estate plans for holdings either at centralized exchanges or on-chain.

With nearly 90% market penetration, clients' portfolios can be checked for any cryptoassets that have been bought, sold, swapped, or airdropped. Sometimes, even the clients can be surprised to learn just what they are holding.

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