AGN Global Business Voice: Business Alert

Making sense of cryptocurrencies: Part #5
What are members telling clients about cryptocurrencies?

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Welcome to the final part of this GBV series seeking to demystify the world of the cryptocurrency – valuable fiscal tool or fantasy investment vehicle with no intrinsic value? Since we conceived of this series a few months back, the market value of Bitcoin, the leading cryptocurrency had hit the heights of U$60,000 per coin, then halved to just over U$30,000, rallying from early August towards the U$50,000 threshold, which it hit on 2 September 2021. Volatility is the hallmark of cryptocurrencies.

In this article we explore some of the views of the professionals within our own member firms. It turns out that cryptocurrency experts are a pretty rare beast – although we suspect this is more to do with a reluctance to step into the spotlight on the topic rather than depth of capability.

One of our contributors, Jon Wedge of BKL in London, is an auditor to the financial services sector in the UK and regularly deals with investment firms, exchanges and other organisations that handle cryptocurrencies. While many are perplexed by the virtual nature of the currencies Jon explains that, *"to a generation who have grown up dealing in Fortnite dollars – it's not such a conceptual leap"*. Younger clients, usually sophisticated fund managers who might have in the past run a successful foreign exchange strategy are now looking at cryptocurrencies – mixing Bitcoin and others in to hi-growth hi-risk strategies. Importantly to them the volatility of the coins offers opportunity for arbitrage. *"These people are high frequency traders – trading 1,000's of times an hour"*.

Our contributor from Australia – Tom Willemsen from Ashfords in Melbourne, has dealt with and indeed invested in Crypto since 2017 – a veteran! Ashfords do advise clients on investments but generally steer clear of cryptocurrencies. They have found that the coins don't match the risk profile of the majority of their clients – and it follows that as demand is low, investment in understanding the various performance and risk profile of some 4,000 different currencies is not a priority. *"It's very easy to make your own tokens – and so there are hundreds of players – many of which are simply a scam"* – so says Tom Willemsen a Senior Advisor from Ashfords.

Patricia Werst from Clark Schaefer Hackett in Cincinnati Ohio has found that clients are generally curious but *"to most it's a hobby, our clients sometimes ask if they should take cryptocurrencies as a payment for their services, and one wonders if that could give them a market access advantage, but the reality is their company would then be taking a highly risky uncontrolled position in a volatile currency market. They don't have to do that."*

Patricia observes that there has been a raft of regulations since 2014, increasing from 2018. *"The IRS is clamping down and targeting crypto-transactors. The main message is - if you transact it, it's taxable, even crypto to crypto"*. In the US, record keeping has become voluminous and complex and tax is usually applied at preferential capital gains rates of 23.8% vs. 37% income marginal rate, unless your business is in crypto trading or mining.

One of the lauded features of cryptocurrencies has always been the anonymity of ownership but as Jon Wedge states *"Across Europe the 5th money laundering directive was designed to regulate the on and off ramps. This means we can identify who is trading in Bitcoin if the institution is complying with the 5th directive"* – and presumably if they're not complying they're breaking the law.

It's a fact that a huge number of retail investors have gone into the cryptocurrency market in last 6-12 months. Jon continues... *"The FCA are getting twitchy as crypto remains un-regulated asset class but in the UK traders have to be registered with the FCA since the beginning of this year"*. One of the perennial problems is that the sector has suffered from lack of formal infrastructure and as Jon observes; *"There are no relevant mainstream institutions in the market and most banks won't handle Bitcoin"*.

Tom Willemsen has noticed something else, *"The Australian Taxation Office (ATO) is playing catch up, they have a framework but lack consistency across various regulatory bodies. When the essential premise of a cryptocurrency is decentralisation how do you report it for tax? Most of the transactions are with overseas' exchanges and so owners may not feel obliged to report domestically through a lack of tax knowledge"*. But the Australian authorities have formed increasingly effective relationships with many of the exchanges to the point that they are confident the data will find its way back and investors will be held accountable.

Should clients invest?

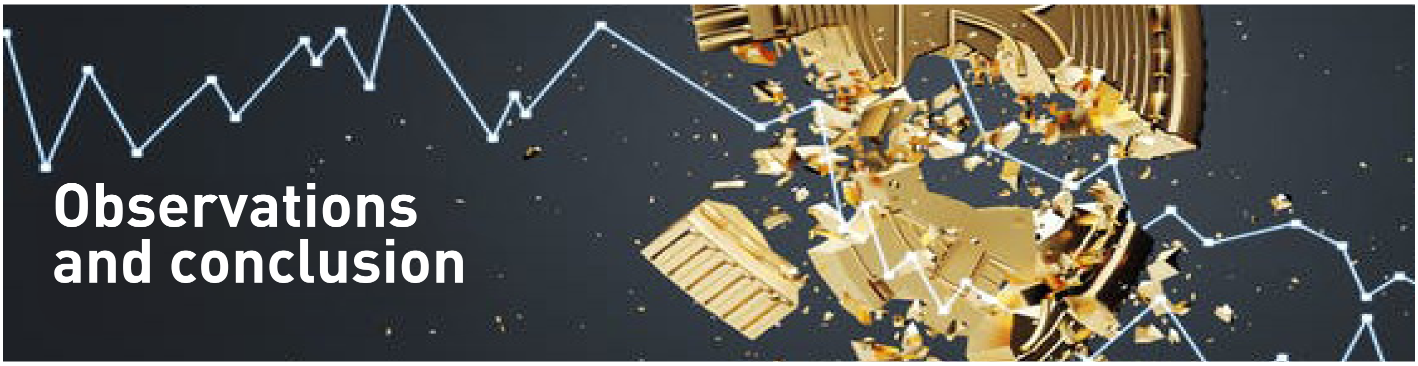
On the whole it would appear that clients are curious about crypto investment opportunities. Patricia at Clark Schaefer Hackett encourages them to conduct a risk driven analysis, to ask themselves how it might contribute to their financial security? Is it in accordance with a business or family plan?[1] Tom from Ashfords sums it up – *"It's not one for those near retirement who need to realise their investments in the near term. Ideally you need to be comfortable with risk, and you need the resources to easily absorb as much as a 20-30% volatility".* Our contributors very much confirmed what we have said throughout – crypto investing is not for the faint hearted.

The future

Interestingly all of our contributors were almost more animated about the future possibilities of the technology behind cryptocurrencies than cryptocurrencies per se. *"Blockchain is a genuine game changer. We've not even begun to imagine the range of applications in financial services that it can be used for"* states Jon Wedge from BKL. It's true that the low-cost end to end secure encryption of any high value transaction, which is what blockchain offers, will impact everyone from the man in the street to governments, financial institutions and the accountancy industry. Whatever the vagaries of cryptocurrencies there is a clear imperative for our firms to stay on top of the developments of the actual technology behind them as the implications for our industry could be profound.

In theory blockchain could enhance the accounting profession by reducing the costs of maintaining and reconciling records, and providing evidence of the ownership and history of assets. This enhanced efficiency could also free up accountants to concentrate on planning, transactions, strategy and valuation, rather than recordkeeping.

1.Appendix A includes some of the early questions the firm addresses with its clients.



Observations and conclusion

- Clients with money to invest are curious about cryptocurrencies and our panel of members have seen interest increase massively in the last couple of years.
- However, those brave enough to invest are still a relatively rare breed – very few have the appetite for such a risky asset class.
- Very few of our members provide investment advice and fewer still advise around the cryptocurrency asset class.
- The informal advice is don't do it unless you can readily absorb a 20-30% negative swing in value.
- Members observe that the early attractions of cryptocurrencies, such as anonymity and security do seem to be eroding over time as governments regulate and institutions have no choice but to conform.
- Cryptocurrencies are no closer to being an everyday currency now than they were when the idea was first mooted. Nearly 4,000 versions of wildly varying stability and reputation don't make this a near term prospect.
- Despite the position of CSH mentioned above, we do know of at least one member prepared to take cryptocurrencies as formal tender for their services but do so via a third-party exchange that guarantee rates of exchange.
- Some individuals within members are engaging in the cryptocurrency world through research, and experimental investing, in order to familiarise themselves with the technology and associated vernacular.
- The same members are curious as to how the underlying technology (blockchain) will develop. How will it affect the profession and the global financial system? And how will client organisations emerge with new products and services derived from the blockchain phenomenon?

HAVE YOU INVESTED?

Arguably a good litmus test for Bitcoin as an investment is whether our trio of experts have entered the market. We can confirm that two out of our three contributors were prepared to admit they held cryptocurrency. One stated the investment was simply to gain a better understanding of what all the fuss was about, and to be properly briefed so they were able to talk knowledgeably with clients. This is a commendable approach but it's interesting to note this was a personal venture and not a research project funded by their firm. The other has been in crypto for some years and has witnessed the quintupling of their original stake, only to see it fall like a stone, to rise, to fall... etc.

They do have an exit plan, and an exit figure. Apparently, they recently came close to that number but not quite... but they are confident they will see that value at some point in the next few months... or... not. Such is the nature of cryptocurrencies.

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Appendix A
Checklist of Considerations in Transacting Business in Cryptocurrency:

Clark Schaefer Hackett have prepared a checklist (below) of things to consider when either your firm or a client of your firm is faced with the prospect of dealing in cryptocurrencies. The list isn't definitive, but it is a good checklist of important matters to consider.

1. **How does transacting business in cryptocurrency apply to your business plan and the future of your business?**
   a) Consider how the business would manage the virtual currency risk?
   b) How will your business account for the virtual currency activity?
   c) What are the key legal considerations facing your business?
   d) What security platforms will you put in place to protect your virtual currency from hackers?
   e) Should the business consider third party custody of the virtual currency?
   f) Should your business consider mining?

2. **Growing use of blockchain technology used in Bitcoins and other cryptocurrencies (CC), contributes to achieving a higher worldwide financial integration.**
   a) Bitcoin and other CC's, are "global" currencies
   b) They grant access to the financial system to anyone who has internet access, making the payment instant.
   c) This is important given that 50% of the world's population does not have formal banking services.
   d) It is best to allow for as many payment options as possible to appeal to a wider customer base.

3. **No Intermediary**
   a) Fewer opportunities to manipulate the transactions.
   b) No permission is needed from any third party to make payment.
   c) Lower transaction fees.

4. **Currency Fluctuation**
   a) Because a CC is less dependent on centralized monetary policies, the values are based on forecasts rather than actual results.
   b) This causes greater volatility in currency values.
   c) Value can vary significantly from when the cost is agreed upon to when payment is made.

5. **It does take time to set up properly**
   a) Business should set up their own crypto wallet and receive payments directly to it.
   b) Additional plugins in order to process the exchange may be required to ensure a safe and practical environment.
   c) A third-party exchange service, which will act as an intermediary between you and the customers, is available, but requires additional transaction fees.

6. **Transaction speed is fast**
   a) Processing payments faster than traditional banking
   b) Due to blockchain tracking of each individual coin and wallet, cryptocurrency payments are secure.
7. **Crypto exchange is still not widespread and may not be acceptable currency to use with potential customers in a specific business environment.**

8. **There are currently no legal regulations that support the cryptocurrency market. Further clarification is required to foster widespread acceptance.**

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