Money Management Institute | 25 Years of Industry Leadership

In association with AON

2022 Advisory Solutions: Expectations and Experiences

PART 3: RISKS AND OPPORTUNITIES FOR WEALTH MANAGERS IN CRYPTOCURRENCIES AND CYBERSECURITY

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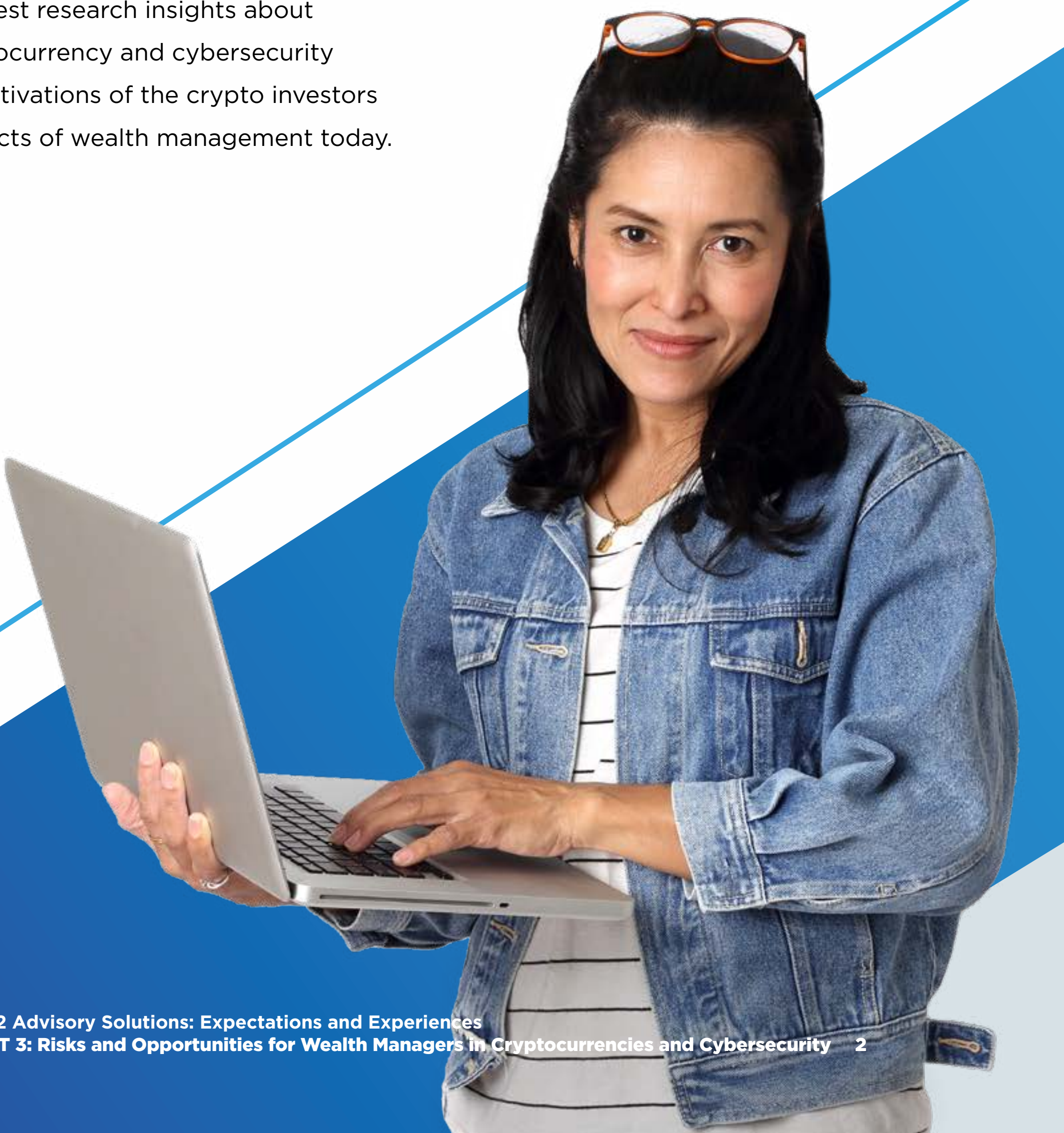
Risks and Opportunities for Wealth Managers in Cryptocurrencies and Cybersecurity

In the last several years, cryptocurrency has rapidly risen in popularity as a viable investment opportunity—particularly among younger digitally-savvy investors who are attracted to decentralized alternatives versus central bank-controlled money. Although many have been drawn to the promise of greater returns, trading in the hype-driven, highly volatile world of digital currency also involves a high level of risk. That risk includes an increased susceptibility to technical glitches and cyber-attacks, which feeds into investors' prevailing concerns about cybersecurity on a broader level. In addition, with industry and global-level regulatory frameworks still under development, there is a significant lack of protection against unscrupulous practices. Our latest research insights about investor attitudes toward cryptocurrency and cybersecurity delve into the mindsets and motivations of the crypto investors who are reshaping certain aspects of wealth management today.



UNDERSTANDING THE CRYPTOCURRENCY LANDSCAPE

During the height of the global health crisis, cryptocurrency was a prime avenue for investors and speculators with extra liquidity and time on their hands, driving exponential price appreciation. The price of Bitcoin alone jumped from $5,165 on March 13, 2020 near the onset of the pandemic to $67,582 on November 8, 2021. The momentum created pressure on wealth management firms to expand their digital asset offerings, as advisors became inundated with client inquiries.

According to our research, approximately 39% of clients have discussed digital investments with their advisors. However, to this day, few traditional wealth management firms have provided access to cryptocurrency, citing concerns regarding the lack of intrinsic value, difficulty valuing currencies, very high volatility, and a lack of regulation. Also, the SEC has been slow to approve crypto funds due to their inherent risks. With Bitcoin in continuing decline and dipping below the $20,000 level in June, investor enthusiasm is also weakening.

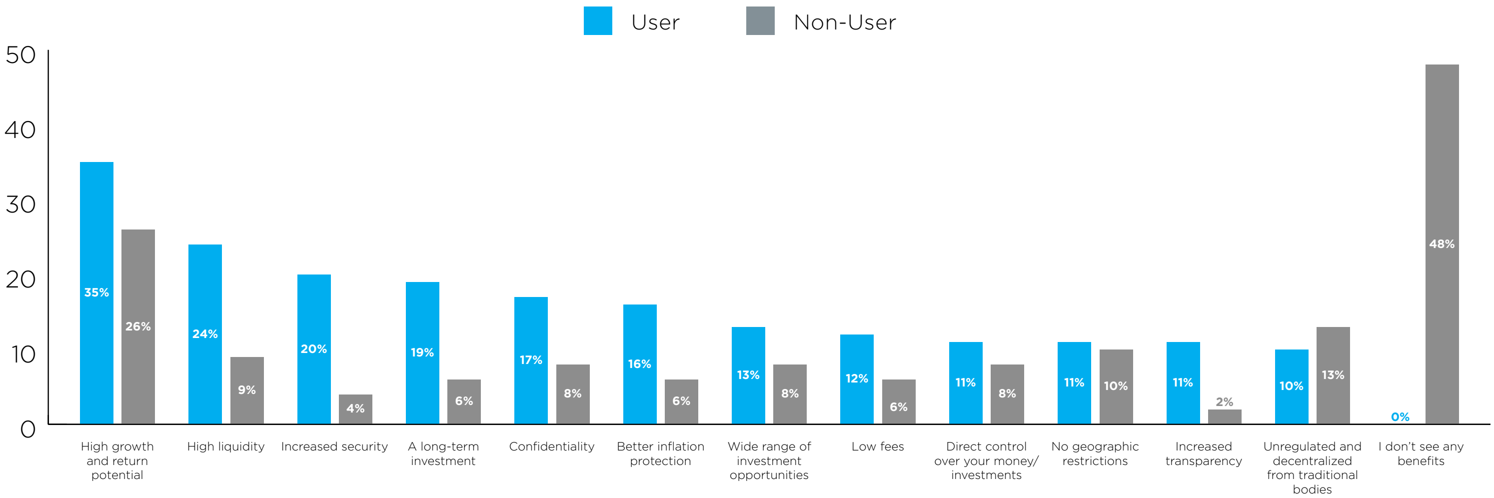
THE MINDSETS AND MOTIVATIONS OF CRYPTO INVESTORS

Digitalization continues to change the ways in which we live and work, impacting investor attitudes toward cryptocurrency. The initial appeal of cryptocurrency lay in its purported decentralized nature and limited availability, as well as in the potential for the elimination of intermediary fees, rapid price growth as rising demand met fixed supply, less devaluation in the face of central bank money supply growth, and personal control over its ownership (Exhibit 1). However, many of these benefits have not held up in recent times due to high trading costs, rapid price declines as investors fled risky assets, and high-profile hacks that compromised cryptocurrency's attractiveness. Overall, demand for cryptocurrency has been largely limited to younger investors as older investor segments remain skeptical about its popularization.

Exhibit 1: Cited Benefits of Cryptocurrency Investments

Younger investors are driven to invest in crypto due to high liquidity and high growth potential

What do you believe to be the TOP TWO benefits of investing in cryptocurrentcies, NFTs, or decentralized finances?



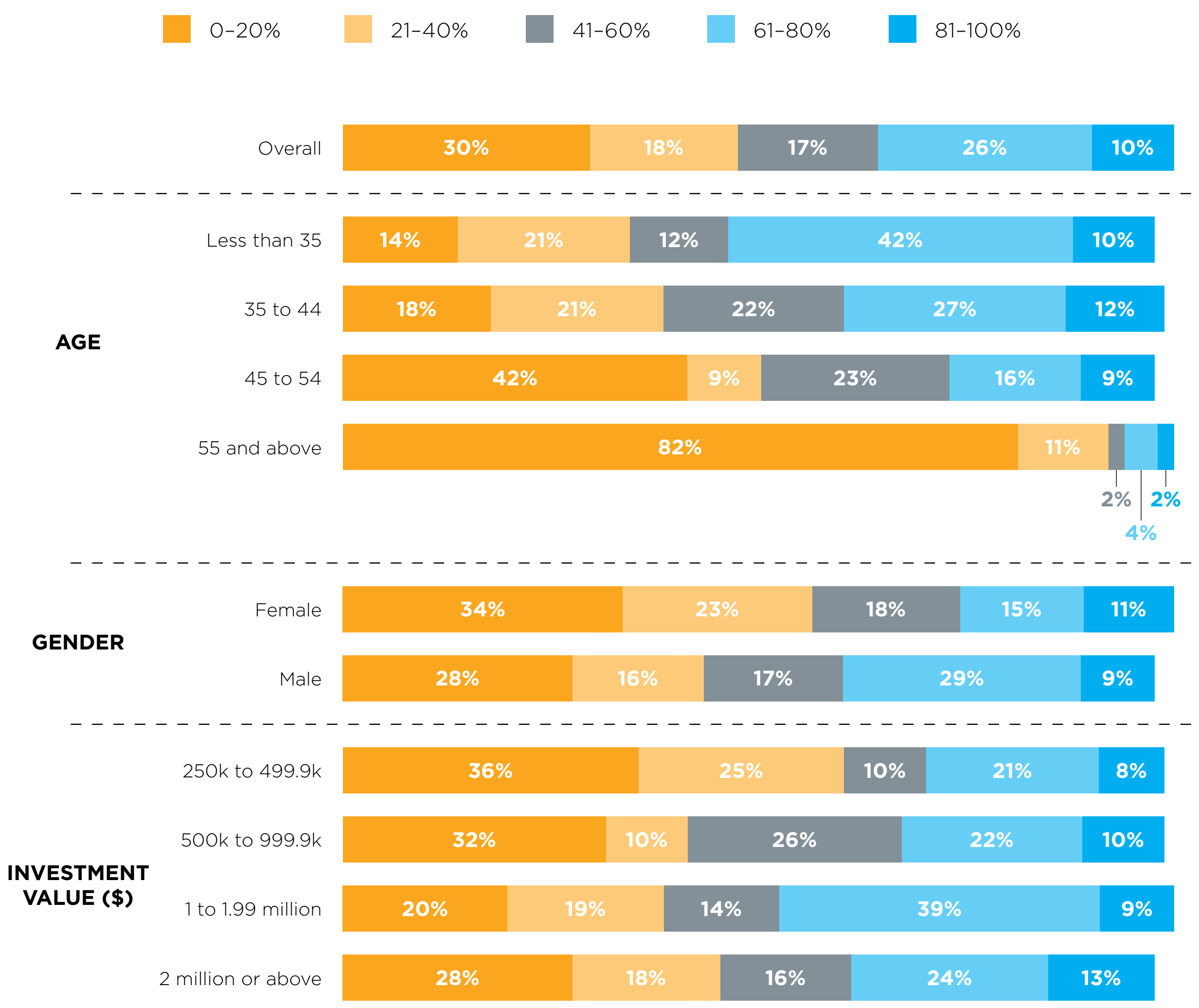
Source: MMI-Aon 2022 Investor Expectations Survey

According to our research, interest in cryptocurrency is strongest among investors younger than 35 (80% of whom hold some cryptocurrency), followed by investors between the ages of 35 and 44 (66%). Besides having a high propensity to invest, the younger investors also allocate a very high proportion of their assets to crypto investments (Exhibit 2). In fact, 52% of investors under 35 were holding at least 60% of their total assets in cryptocurrency when this research was conducted in the Spring of 2022.

Exhibit 2: Cryptocurrency Portfolio Allocations by Demographic Group

Younger crypto users (<35 years old) are quite aggressive in their crypto investments with approximately 50% holding > 60% digital assets as part of their portfolio

You mentioned that you hold cryptocurrencies, NFTs, and/or other digital assets as part of your investment portfolio. Approximately what percentage of your total portfolio is in these assets currently?



Source: MMI-Aon 2022 Investor Expectations Survey

ADDRESSING THE REALITY OF CRYPTOCURRENCY RISKS

Concentrating investments in a high-risk asset class like cryptocurrency, as our respondents have done, is reminiscent of the internet stock-investing craze of the late '90s, with potentially equally disastrous results. As their portfolios have already declined by more than 50% since prices peaked, young crypto investors who over-allocated to this asset class will need guidance from their advisors to get their investment strategies and financial goals back on track. Given the turbulent equity and bond market environment caused by the ongoing repercussions of the pandemic, this won't be an easy task.

Although their approach to accumulating wealth in digital currency may seem aggressive, crypto investors are not unaware that their assets are volatile and risky. According to our research, while they generally believe that their risks were justified—with high growth potential and returns being the most cited benefit of crypto investing (35%)—market volatility (24%) was the greatest risk identified, followed by cybersecurity and lack of inherent value (12%). Unfortunately, all these risks have been realized.

THE POTENTIAL ROLE OF WEALTH ADVISORS IN CRYPTO INVESTMENTS

Forbes reporting that there are nearly 600 cryptocurrency exchanges worldwide as of July 2022 is indicative of the increasing number of crypto-focused platforms being made available to investors looking to expand their portfolios. Although our research indicated new platforms like Coinbase and Crypto.com are the most preferred, Schwab, TD Ameritrade, and Robinhood are also being used by 12%, 12%, and 22% of crypto investors, respectively.

However, only 14% of the investors surveyed indicate they would be very likely to add crypto to their portfolio if their wealth management firm offered it, with 21% being somewhat likely to do so. With demand having eroded further since this research was conducted in the Spring of 2022, wealth management firms don't need to be in any hurry to offer cryptocurrency in the near future.

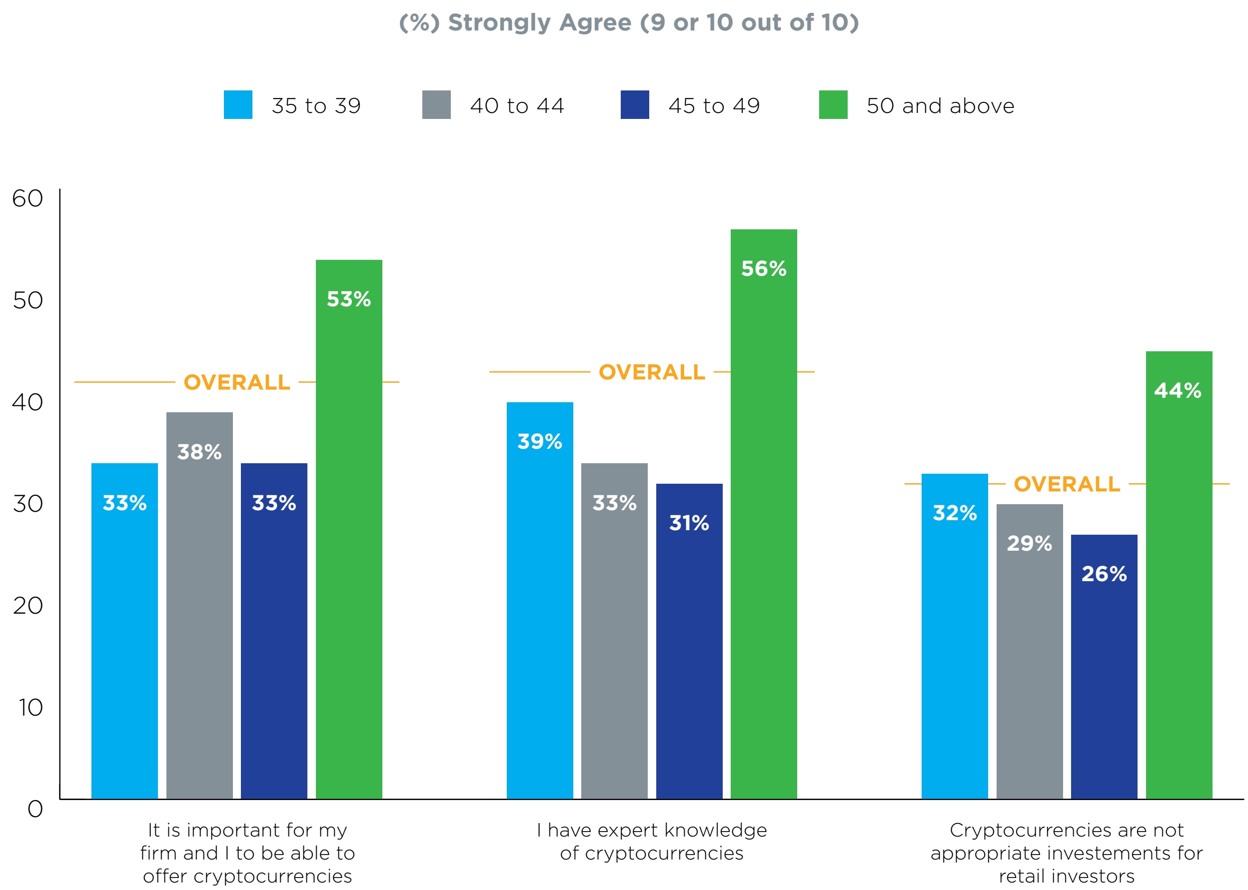
As we move forward, a clear regulatory framework for cryptocurrencies will be a prerequisite for improving the appeal of this asset class to investors. In the meantime, wealth advisors can point younger investors with a high appetite for risk and an interest in innovation toward technology stocks and private equity opportunities that have better fundamentals, research coverage, and regulatory safeguards.

Many of the advisors we surveyed did express an enthusiasm for cryptocurrency, with 42% claiming to have expert knowledge of the topic and an equal proportion believing that their firm should offer it to their clients (Exhibit 3). On the other hand, a significant minority (31%) do not believe that it is an appropriate investment for retail investors. Understandably, these crypto-skeptical advisors were more likely to be the over 50-year-olds who experienced the highs of the dot-com bubble and its subsequent crash.

Exhibit 3: Advisor Attitudes Toward Cryptocurrency Investing

42% of advisors believe they have expert knowledge of cryptocurrencies and crypto wallets

How strongly do you agree with each of the following statements below?



Source: MMI-Aon 2022 Advisor Expectations Survey

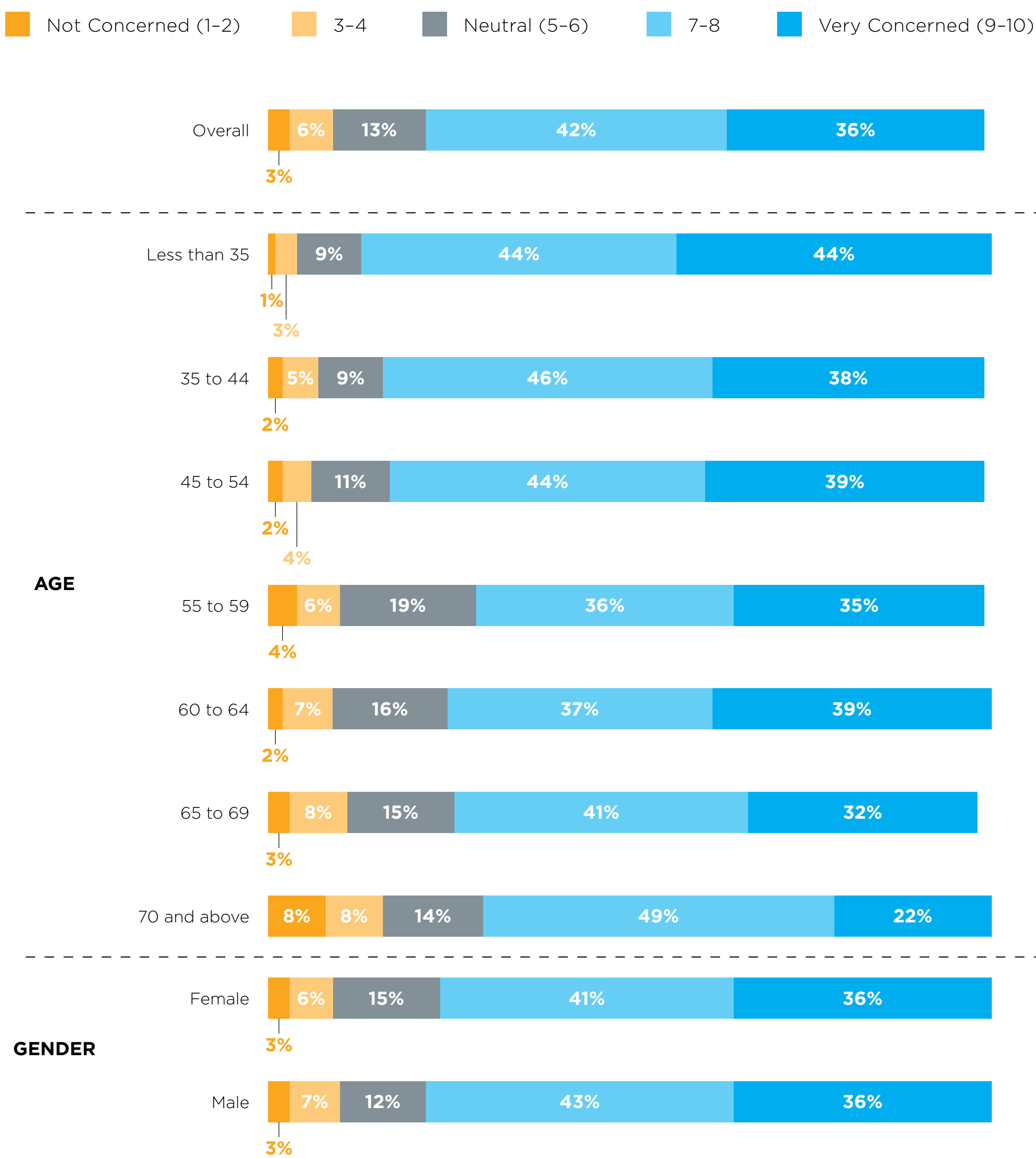
OPPORTUNITIES FOR WEALTH MANAGERS IN ADDRESSING CYBER-RISK

As digital delivery becomes a more integral component of the wealth management experience—for digital as well as other types of investments—cyber-risk has grown as a very significant concern for both clients and advisors (78% and 87%, respectively). Investor concern about cyber-risk is inversely proportional with age, in that the under-35s who are the most active digital users are also the most concerned with cyber-risk (88%) (Exhibit 4). However, 86% of advisors are quite confident of their firm's ability to safeguard their clients' information and identities. To drive more adoption of their digital services, wealth management firms must reassure their clients about the security protocols they have in place and collaborate with investors to implement best practice processes, such as firewalls, password hygiene, and anti-virus protection software.

Exhibit 4: Investor Attitudes Toward Wealth Manager Cyber-Risk

Clients are very concerned about cyber-risk and concern is inversely proportional with age—with younger clients who are the highest users of digital the most concerned

How concerned are you about identity theft and cyber losses?



Source: MMI-Aon 2022 Investor Expectations Survey

If wealth management firms see their core mission as protecting their clients' financial health, offering cybersecurity products would not only advance their mission, but also safeguard their own firm from hacking incidents that originate from their clients' poor security hygiene. Unfortunately, both advisors and many of their clients today find their wealth management firms' existing security procedures difficult to navigate—46% of clients and 76% of advisors in our research admitted to finding these procedures difficult. Implementing biometric user authentication tools involving facial, fingerprint, and/or voice recognition, for example, would greatly enhance security and convenience.

Furthermore, our research showed that investors who are highly confident in their wealth management firm's cybersecurity are almost three times more likely to be highly satisfied with their overall wealth management experience. However, only 52% of investors are highly confident in their wealth management firm's cybersecurity, indicating that the industry would do well to invest in improving the quality and convenience of cybersecurity and, more importantly, highlighting this critical feature.

KEY TAKEAWAYS

+ Although approximately 39% of clients have asked their advisors about cryptocurrency investments, investor interest is now limited and declining. Wealth management firms should be in no hurry to add crypto investments to their product portfolios while legal and regulatory frameworks are still uncertain.
+ Interest in cryptocurrency is strongest among investors under 35, with 80% of the under-35s holding some form of digital asset. 52% of them hold at least 60% of their portfolio in cryptocurrency, with men being twice as likely as women to invest in cryto.
+ High growth and return potential were the most cited benefit of crypto investing, while market volatility was identified as the greatest risk, followed by cybersecurity concerns and lack of inherent value.
+ Only 14% of investors indicated being very likely to add crypto to their portfolio if their wealth management firm offered it, while 21% would be somewhat likely to do so.
+ 42% of advisors claim to have expert knowledge of cryptocurrency, with an equal proportion believing that their firm should offer it to their clients. The significant minority of advisors who believe otherwise are the over 50-year-olds who experienced the dot-com bubble and its subsequent crash.
+ Cyber-risk is a very significant concern for both clients and advisors. Younger clients under 35 who are the most active digital users are also the most concerned about cyber-risk.
+ Investors who have confidence in their wealth management firm's cybersecurity are almost three times more likely to be very satisfied with their wealth manager. However, only 52% of investors indicate being highly confident in their wealth management firm's cybersecurity.

KEY ACTION POINTS FOR WEALTH MANAGEMENT FIRMS AND ADVISORS:

+ Engage with clients, particularly younger investors, on their crypto investments and advise them on more effective approaches for meeting their risk and return goals and ensuring their portfolios are well diversified.
+ Guide investors who over-allocated to the digital asset class to bring their investment strategies and financial goals back on track.
+ Help inexperienced investors build more robust investment strategies by stress-testing their portfolios with realistic scenarios for highly risky assets.
+ Reassure clients about their wealth management firms' security protocols while collaborating with investors to implement best-practice security processes.

QUESTIONS?

Contact MMI by email at info@mminst.org or call us at (646)-868-8500.

OUR RESEARCH

This article is part of a three-part series—based on proprietary research by the Money Management Institute and Aon—that explores both investor and advisor views of the value of investment advice and how it is delivered. The complete series will explore the gaps that have emerged between client expectations and advisor and firm delivery in the following areas: Emerging Retirement Planning Gaps in a Post-Pandemic World, the Investor and Advisor Digital Experience, and Risks and Opportunities for Wealth Managers in Cryptocurrencies and Cybersecurity.

About the Money Management Institute (MMI)

Established in 1997, the Money Management Institute (MMI) is the industry association representing financial services firms that provide financial advice and investment advisory solutions to investors. Driven by our promise of increasing connections, knowledge, and growth for our members, MMI is dedicated to fostering professional relationships, sharing experiences, and expanding the industry's influence through advocacy and education.

MMI offers premier professional development programs, specialized curriculums, and facilitates peer-to-peer connections through our communities and conferences. As part of MMI's longstanding commitment to diversity and inclusion, the Gateway Foundation provides clear pathways to entry and career advancement in the financial services industry for historically excluded and underrepresented groups. MMI member firms include wealth manager, asset manager and solutions provider firms of all sizes and professionals representing all functional areas. Follow MMI on LinkedIn.

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