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Digital assets: Handle with care

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Digital assets are now owned by some of the world's wealthiest individuals and families. While the jury is still out in some jurisdictions in relation to the legal and tax status of these assets, holding them through corporate vehicles or trust structures is obviously going to be an attractive choice for high-net-worth individuals.

But what are the challenges? What can go wrong? What can trustees do to avoid the pitfalls, protect the beneficiaries and importantly protect themselves?

As I write, crypto assets are in the limelight for the wrong reasons with the value of Bitcoin and other currencies struggling, a red flag to any trustees who have invested in crypto, but still, we can expect the next generation of clients to be using these assets on a regular basis in 10 years' time.

Volatility of this asset class was always a risk with the vast price swings creating challenges and potential trustee liability, depending on how they manage it. But while those issues can be managed and third parties brought in to help, there remain other risks that trustees must be alert to.

The first is around reputational harm. If an asset is being held that's not a mainstream cryptocurrency asset, for example, a niche token that's recently been created by a small developer, being associated with that project exposes a trustee to criticism for investing or taking a large stake in the project. If that asset later turns out to fail or to fall subject to regulatory scrutiny, such that the trustee has to take (public) action to protect the trust's position, there is a risk to the trustee's reputation.

Then there is the issue of digital asset regulation, with many assets not falling within the regulatory perimeters of a jurisdiction, or because the regulations differ from one jurisdiction to another, raising further challenges for trustees. They might need additional authority to handle the asset in a particular jurisdiction. For example, if it's a token that looks like a share, does that stray into a different regulated territory or regime?

Trustees must be alert to the fact that crypto assets are often used as a means to transmit the proceeds of crime or have themselves been misappropriated from owners by various means, sometimes due to failures in cybersecurity protocols. Because of the speed and ease in which digital assets can be transferred trustees must be alive to the need for super-enhanced due diligence measures.

The general level of uncertainty around digital assets should be a warning to trustees. Whilst investment certainly isn't a no-go area, these are not assets to be played with – trustees must put in place specific policies and procedures for dealing with them.

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Seeking professional advice early is key. Advisers can assist in implementing which tools can be used to protect a trust from the risks of a crypto investment.

Lawyers will advise on how best to structure the asset holding vehicle to minimize the potential for trustee liability – exclusions, limitations, indemnities etc.

Research on an ongoing and regular basis is essential. The changing regulations, fluctuating values and so on require trustees to keep their fingers on the pulse. Specialist investment advisers can assist.

Liaising with the regulators when needed and involving industry experts at all stages from the structuring stage through to due diligence, not only protects the trust and assets, but increases the likelihood of issues being flagged at an early stage and thus reduces the risk of trustees being exposed to litigation further down the line.

Far from being a flash in the pan, digital assets look like they are here to stay and can, if handled with care, be a valuable addition to a trust portfolio or corporate vehicle but considerable thought needs to be given to how the assets are held.

This article by Christian Hay, Managing Partner and Head of Dispute Resolution in Guernsey, was first published in eprivateclient on 7 July. Click here to view the article on epc.

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