The Wild, Wild West: Understanding Cryptocurrencies and Their Implications on Financial Planning

by Ana Trujillo Limón

They've been described by some as the wild, wild West. Others have compared them to the Beanie Babies craze in the '90s. Some say they're a fad; others are champions of them. No matter where you fall on that spectrum, there's no doubt cryptocurrencies have shaken things up in the past year.

Though cryptocurrency has been around since 2008, launching with the white paper[1] by the mysterious Satoshi Nakamoto, interest in them peaked at the end of 2017 when the value of Bitcoin exploded and subsequently crashed early this year.[2]

Even if you think cryptocurrencies are a fad that's best avoided or they're simply not a viable investment option (which is how a combined 44 percent of planners feel, according to FPA's 2018 *Trends in Investing* survey), it's a good idea to know a few basics about cryptocurrencies and the technology behind them—blockchain, said Douglas A. Boneparth, CFP®, AIF®, president at Bone Fide Wealth.

"Advisers have a duty to be aware of things going on around them," Boneparth said. "Worst-case scenario is you end up learning something that may not be useful in the future, but it's certainly useful right now. You've got nothing to lose but time. If you choose not to [get educated on cryptocurrencies], you run the risk of getting left behind."

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It is not wise to simply discount cryptocurrencies, said Justin Castelli, CFP®, CIMA®, founder of RLS Wealth Management.

"Even though it's new and it's a very volatile asset class, I don't think advisers should just dismiss it and write it off," Castelli said. "I don't recommend my clients invest in it, and I don't recommend what coins to consider, but I do help educate them and let them make a decision."

Your clients or your clients' children may have invested in some form of cryptocurrency, and if they haven't already, they might come to you with questions.

"You are going to have to know about it and be ready to deal with it and plan for it," said Jamie Hopkins, J.D., LL.M, CLU®, ChFC®, CFP®, RICP®, associate professor at The American College of Financial Services. "A tremendous amount of people have it."

At the bare minimum, you need to be familiar with concepts and lingo to build trust with your clients, said Bobby Henebry, CFA, owner of Henebry Blockchain and Cryptocurrency Consulting.

"It's an opportunity for [advisers] to understand where they can make their clients money and an opportunity to protect their clients from losing money—if they can do one, the other, or both," said Henebry, who left his career as a financial adviser to educate investors and groups on blockchain technology and cryptocurrency. "If they are going to ignore this, they're putting their business at risk and their clients at risk by not being proactive."

Here are a few terms and concepts to understand to help you be more proactive.

Cryptocurrencies. Developed in a time of high distrust in the traditional banks, these digital currencies are native to the internet, "mined" by people and organizations, and not issued by governments.[3,4]

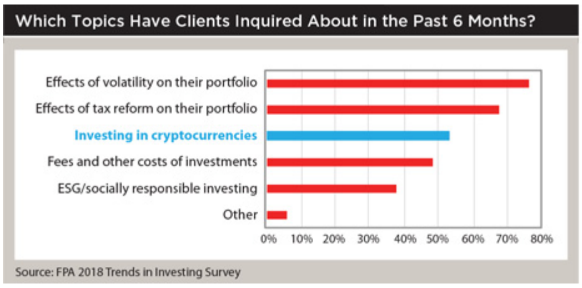
Blockchain technology. If cryptocurrencies are train cars, then blockchain technology is the rails on which they run, said Brenda Smith, CFP®, chair of the investment group Tiger 21. Blockchain is essentially an open distributed ledger where entries are put in but never erased. It is a system for digital interactions where there is no need for a trusted third party.[5] *Harvard Business Review* reports that "in a blockchain of identical databases, each hosted and maintained by an interested party. When changes are entered in one copy, all the other copies are simultaneously updated."[6]

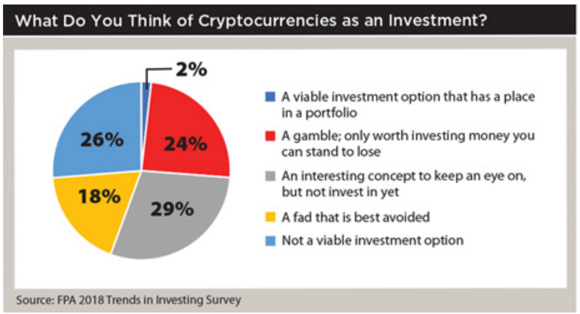
Mining. Mining is the mechanism by which transactions are approved and added to the public ledger. Essentially, the miners help build the "blocks" in the blockchain in order to approve and process transactions. Mining is also how new units of Bitcoin and other cryptocurrencies are released.

Initial Coin Offering (ICO). The ICO is an unregulated way for startups to raise money for a new cryptocurrency venture.[7]

Hanh Nguyen, partner at Yossarian Capital Partners and co-founder of Complect, an online freelancing platform connecting financial services firms and compliance specialists, noted that planners should differentiate between cryptocurrencies the securities (ICOs) and cryptocurrencies the commodities (the currencies themselves, like Bitcoin, Litecoin, and Ethereum).

"Once you recognize that distinction, you can recognize how that plays into the diversification of your clients' portfolios," Nguyen said.





What Planners Are Telling Clients

The mania surrounding cryptocurrencies seems to be gone, but the curiosity is still there. FPA's 2018 *Trends in Investing* survey found that 53 percent of planners surveyed said their clients have inquired about investing in cryptocurrencies in the past six months.

We don't recommend it either way. Many planners interviewed for this article said it's likely future, but they’re not currently recommending them to clients. In fact, only 1.4 percent of planners surveyed in FPA’s 2018 *Trends in Investing* survey currently recommend cryptocurrencies as an investment option to their clients.

Boneparth of Bone Fide Wealth has found a hobby in mining cryptocurrency, but he doesn’t talk about that with clients.

“You will never see me recommending it one way or the other,” he said.

Hopkins of The American College falls into that camp also. “I wouldn’t be advising anyone to invest in digital currencies,” he said. “It’s fairly unregulated and that seems like a clear way to get in trouble with regulators today.”

Only invest what you’re willing to lose. Hopkins said planners need to encourage their clients to be cautious, and it seems most of them are.

For example, Smith of Tiger 21 says she doesn’t discourage her clients, but tells them only to make a small investment.

“If you’ve got play money and you want to speculate, put a very small amount of money in,” she said.

Stacy Francis CFP®, CDFA™, CES™, president and CEO of Francis Financial, said if clients are determined to invest, then she gives them the same advice she gave her husband when the pair themselves invested in Bitcoin several years ago: pick the amount you’d be most comfortable throwing in the garbage and that won’t impact your retirement. For Francis and her husband, that was $100.

“That in no way put our retirement at risk,” she explained.

Adam Cmejla, CFP®, founder and president of Integrated Planning and Wealth Management, is also cautious.

“I jokingly tell clients, if you’re going to put your money in cryptocurrency, go to Vegas. The lights are prettier,” he said.

Even when you caution your clients, they still might want to move forward, said Mario Nardone, CFA, president and founder of East Bay Financial Services, in which case, you should drive the point home.

“If … they still want to dabble, then my job becomes persuading them not to risk more than they could afford to lose,” Nardone said.

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It's risky. Cryptocurrencies bring a lot of risk and volatility to a client's portfolio. At the end of 2017, Bitcoin reached a high of $19,343[8] and fell to a low of $6,127.21 at the beginning of 2018.[9]

"If [cryptocurrency] has a place in your portfolio, this really represents the most risky asset," Francis said. "Yes, it has great potential, but it also has great potential for loss."

Why do you want to get in on this and do you understand it? Cmejla noted that asking clients why they want to invest in cryptocurrencies can help flush out whether they should.

"If you ask 'why' three times, you'd be amazed at what answers you get from clients," Cmejla said.

For Francis, she tells her clients that if they don't understand the basics of cryptocurrency, they shouldn't invest in it.

"It's not an investment that is right for 99 percent of the population," Francis said, admitting that she wouldn't have invested in Bitcoin had her husband not been in the tech industry. "The people it is right for are: one, those who may be in the tech field themselves; and two, people who have money they don't need."

Do not make an emotional decision about cryptocurrency. At the height of the meteoric rise of Bitcoin, clients were likely asking how to climb aboard this ride. Some clients may have had "fear of missing out" or FOMO. Navigating the emotional aspect of wanting to get in on something that's in the spotlight isn't new for financial planners.

"Financial planners worth their salt have been cautioning clients for years about get-rich-quick schemes and the counterproductive nature of worrying about how the neighbors got what they have," Nardone said.

Cryptocurrency is very emotional because it's very volatile, according to Smith of the investment group Tiger 21—the idea of gaining or losing lots of money activates the body's pleasure and pain centers.

"If the choice is made to invest in cryptocurrency, you have to keep your head above your heart and know there's a possibility you could lose everything while you're in the game," she said. "You can't let your emotions get the better of you; you need to stay logical."

Picking the winners is tough. Trying to pick the winner in the cryptocurrency game is like trying to play pool on a cruise ship in the middle of a

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winning cryptocurrency is like trying to pick which website was going to make it big in the 1990s. That didn't work out well for many investors.

Tax Planning Implications

The tax law regarding cryptocurrency is developing, according to Randy Gardner, J.D., LLM, CPA, CFP®, founder of Goals Gap Planning and tax planning columnist for the *Journal*.

"Gains from sales will be taxable and losses deductible like other capital assets," Gardner said, because the IRS does view cryptocurrencies as capital assets.[10]

Although cryptocurrency exchanges are not yet required to send out 1099 forms, some exchanges, like Coinbase, do send 1099s to certain users, such as those who have received at least $20,000 cash from selling virtual currency in at least 200 transactions in a calendar year.[11] If your clients are using an exchange that does not send out 1099 forms, the onus is on them to report it.

That $100 that Francis and her husband invested in Bitcoin turned into $14,000.

"We were looking at paying taxes on earnings of $13,900, which was pretty significant," she explained, so they transferred the Bitcoin to charity and were able to write off the earnings. Plus, the charity was able to sell it tax-free.

Early in the tax season, nearly 60 percent of taxpayers surveyed said they had recognized gains from cryptocurrency, however less than 0.04 percent of all taxpayers had reported gains from cryptocurrency as of February.[12]

"You need to advise your clients to pay their taxes every time they sold any cryptocurrency," said David Haas, CFP®, president of Cereus Financial Advisors. "It's either a gain or a loss—even if it's not reported on a 1099. If you've realized a gain or a loss, you need to report it."

Estate Planning Implications

Estate planning for cryptocurrencies has two elements—both require directing clients to update their wills, trusts, and powers of attorney.

First, according to Hopkins of The American College, is the digital asset aspect of it.

"That's really where advisers need to pay attention," he said. If your clients own cryptocurrencies, ensure that they know the digital assets upon their death. However, these log in credentials should not be listed in a will as that document becomes public upon a client's death.[13]

Second, know that for the time being cryptocurrency is treated as personal property, like a painting or a car. Therefore, Francis said clients need to designate in their estate planning documents to whom the assets will go (Castelli of RLS Wealth Management noted that cryptocurrency exchanges don't have the option to designate a beneficiary). Cryptocurrency assets will be considered part of a client's taxable estate.

Blockchain May Be the Big Story

Despite the media buzz about the currencies themselves, blockchain technology may be the big news. If the individual cryptocurrencies are like the individual websites in the dotcom bubble, then blockchain technology is like the internet.

Companies including IBM, Walmart, Kodak, Hitachi, Maersk, British Airways, and UPS are already using blockchain technology to do things like manage data, manage cargo, and solve customer disputes.[14] *Forbes* recently touted the top blockchain investments investors might want to look into this year and a few of those companies were on the list.[15]

This permanent distributed ledger technology could make for more stable financial infrastructure and more efficient processes with less chance for human error.[16]

"The technology is here to stay," Hopkins said.

Castelli agreed.

"A lot of smart minds are leaving technology companies and biomedical companies and coming into the blockchain space," he said. "There are too many major players getting into it for it to be going away."

Looking into the Crystal Ball

Are cryptocurrencies here to stay? Most of the planners and experts the *Journal* interviewed said yes, but we will probably only have one major cryptocurrency in the future, and in order for it to gain full market acceptance a few things need to happen.

First, cryptocurrencies need to become regulated, less volatile, and easier to use. Cryptocurrencies are not considered a legal tender and they are currently unregulated, although the Commodity Futures Trading Commission views Bitcoin specifically as a commodity, and as mentioned earlier, the IRS views cryptocurrency as property.[17]

"General acceptance is going to come with regulation and ease of use," Boneparth said. "You have to make it very easy to use."

Second, mainstream banks need to open cryptocurrency trading desks, according to Francis—a move that could be on the horizon. A recent Thompson Reuters survey showed that one in five financial firms, including mainstream banks, are considering opening cryptocurrency trading desks within the next year.[18] Also, Nasdaq's CEO Adena Friedman recently went on record saying that the stock exchange would consider becoming a cryptocurrency exchange.[19]

The SEC has made its first move toward regulation of cryptocurrencies and ICOs, noting in a March statement that it considers these assets "securities" under federal securities laws.[20] It also issued subpoenas for online cryptocurrency trading platforms and companies that have conducted ICOs.[21]

"I do think it will have market acceptance and be less volatile," Francis said. "As far as when, that time is far off."

Ana Trujillo Limón is associate editor of the *Journal* and editor of the FPA Practice Management Blog. Email her HERE. Follow her on Twitter at @AnaT_Edits.

Endnotes

1. See Satoshi Nakamoto's 2008 white paper "Bitcoin: A Peer-to-Peer Electronic Cash System," available at bitcoin.org/bitcoin.pdf.
2. See "Bitcoin Plunges to $10,000, Half Its Peak Price, as Investor Fears Blossom," in *Fortune* at fortune.com/2018/01/17/bitcoin-price-crash-regulation.
3. See "What Are Cryptocurrencies: A Brief History of Bitcoin," from Motley Fool at fool.com/investing/2017/11/27/what-are-cryptocurrencies-a-brief-history-of-bitco.aspx.
4. See "What Is a Cryptocurrency?" from Nasdaq at nasdaq.com/article/what-is-a-cryptocurrency-cm910816.
5. See "What Is Blockchain Technology?" from coindesk at coindesk.com/information/what-is-blockchain-technology.
6. See "The Truth About Blockchain," in *Harvard Business Review* at hbr.org/2017/01/the-truth-about-blockchain.
7. See Investopedia's definition at investopedia.com/terms/i/initial-coin-offering-ico.asp.
8. See "The Rise—and Fall—of the Cryptocurrency Millionaires," in the *Financial Times* at ft.com/content/d0df4322-1559-11e8-9c33-02f893d608c2.
9. See "Bitcoin Price Falls Below $7,000," in *Fortune* at fortune.com/2018/04/04/bitcoin-price-falls-below-7000.
10. See IRS Notice 2014-21 at irs.gov/pub/irs-drop/n-14-21.pdf.

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12. See “Get Ready to Laugh: Here’s How Many Americans Have Reported Crypto Transactions in Their Tax Filings,” from Motley Fool at fool.com/taxes/2018/02/19/get-ready-to-laugh-heres-how-many-americans-have-r.aspx.
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15. See “Top 5 Blockchain-Related Stocks for 2018, and a Few to Avoid,” in *Forbes* at forbes.com/sites/ericervin/2018/02/08/top-5-blockchain-related-stocks-for-2018-and-a-few-to-avoid/#555d7e086ce2.
16. See “Like the Early Web, Cryptocurrency Represents Big Risks and Major Opportunity,” from *The Hill* at thehill.com/opinion/technology/382207-like-the-early-web-cryptocurrency-represents-big-risks-and-major.
17. See “Your Guide to Cryptocurrency Regulations Around the World and Where They Are Headed,” from CNBC at cnbc.com/2018/03/27/a-complete-guide-to-cyprocurrency-regulations-around-the-world.html.
18. See “20 Percent of Financial Firms Such as Banks and Hedge Funds Are Looking to Trade Cryptocurrencies Soon, Survey Finds,” from CNBC at cnbc.com/2018/04/24/20-percent-of-financial-firms-are-looking-to-trade-crypto-in-2018-survey.html.
19. See “Nasdaq Open to Cryptocurrency Exchange in Future, Says CEO,” from Reuters at nasdaq.com/article/nasdaq-open-to-cryptocurrency-exchange-in-future-says-ceo-20180425-01217.
20. See the SEC’s “Statement on Potentially Unlawful Online Platforms for Trading Digital Assets” at sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading.
21. See “Cryptocurrency Firms Targeted in SEC Probe,” in *The Wall Street Journal* at wsj.com/articles/sec-launches-cryptocurrency-probe-1519856266.

Sidebar: Resources for Further Learning

The following resources have been helpful to the professionals interviewed for this article and could also be helpful for you:

Blogs. A wealth of information about cryptocurrency and its financial planning implications is available in Justin Castelli’s blog, AllAboutYourBenjamins.com.

Podcasts. Several podcasts provide up-to-date information and the latest cryptocurrency news. A few helpful ones are “Unchained,” “The Bitcoin Podcast Network,” and “Coin Mastery.” For a full list, see “8 Crypto Podcasts You Should Listen to in 2018” from *Medium* at medium.com/@argongroup/8-crypto-podcasts-you-should-listen-to-ade5344e05b6. Castelli also recommends Patrick O’Shaughnessy’s “Invest Like the Best” podcast.

News outlets. A few news outlets have sections dedicated specifically to cryptocurrency. CNBC’s Bitcoin section (cnbc.com/bitcoin) keeps up with the latest news. *Financial Planning, InvestmentNews, Forbes, Fortune, The Wall Street Journal,* and *The New York Times* are also helpful resources.

Cryptocurrency websites. Several websites dedicated specifically to cryptocurrency news have popped up recently. Some of the most helpful ones include Coindesk.com, News.Bitcoin.com, and the-blockchain.com.

Books. If you have the time to invest, *Blockchain Revolution How the Technology Behind Bitcoin Is Changing Money, Business, and the World* by Don Tapscott and Alex Tapscott is one resource. Other books include *Digital Gold* by Nathaniel Popper and *The Age of Cryptocurrency* by Paul Vigna and Michael J. Casey. For more book recommendations, see the CNBC article “6 Must-Read Books about Bitcoin” at cnbc.com/2017/12/28/4-books-to-

Meetup Groups. Bobby Henebry has found a wealth of information through local Meetup groups (meetup.com). Austin and Atlanta both have strong Meetup groups, and the cryptocurrency and blockchain communities are generally open and eager to explain the basics to newcomers.