

# Valuation of Crypto Assets

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Rule 206(4)-7 under the Investment Advisers Act (IAA)—the so-called Compliance Program Rule—requires an investment adviser registered under the IAA to (among other things) adopt written compliance policies and procedures reasonably designed to prevent violations of the IAA by the adviser and its supervised persons.

When it adopted the Compliance Program Rule, the Securities and Exchange Commission explicitly stated that:

each adviser, in designing its policies and procedures, should first identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm's particular operations, and then design policies and procedures that address those risks.

The SEC also stated it expected each adviser's policies and procedures to address, at a minimum, certain enumerated issues to the extent they are relevant to the adviser's operations.

One of those enumerated issues is "processes to value client holdings and assess fees based on those valuations."<sup>[1]</sup>

Sound valuations, of course, are important for several purposes:

- the adviser's registration and reporting obligations with respect to "regulatory assets under management" are based on such valuations, as discussed in our January 24 post [here](#);
- the advisers' fees are based on such valuations;
- such valuations are integral to an adviser's presentation of its performance; and
- such valuations are necessary to ensure proper NAVs at which investors invest in and withdraw from commingled investment products on a monthly, quarterly, or other periodic basis.

Although private funds, unlike registered funds, typically are not required to value their assets on each business day and to strike a daily NAV, private funds often offer periodic subscription and withdrawal dates and therefore are required to strike periodic NAVs for purposes of processing related subscriptions and withdrawals.

# Crypto Valuation Issues Raised by the Blass Letter

On January 18, 2018, Dalia Blass, Director of the SEC's Division of Investment Management, wrote a letter addressed to the Investment Company Institute and the Securities Industry Financial Markets Association (the Blass Letter), which can be found [here](#).

The Blass Letter focuses primarily on describing a number of potential issues relating to investments in cryptocurrencies<sup>[2]</sup> by **mutual funds** and **exchange-traded funds** (ETFs).

The Blass Letter did not expressly state that the SEC staff has similar concerns about investment advisers that manage cryptocurrency portfolios of clients other than mutual funds and ETFs. Some of the concerns raised in the Blass Letter, however, do in fact apply to a large extent to investment advisers that manage other types of accounts. One of those concerns is the valuation of crypto assets.

The Blass Letter raises many important questions relating to valuation, including the question of whether advisers have the "information necessary to adequately value cryptocurrencies or cryptocurrency-related products, given their volatility, the fragmentation and general lack of regulation of underlying cryptocurrency markets, and the nascent state and current trading volume in the cryptocurrency futures markets..."

The relevant valuation questions posed by the Blass Letter are as follows:

- How would funds develop and implement policies and procedures to value, and in many cases "fair value," cryptocurrency-related products?
- How would funds' accounting and valuation policies address the information related to significant events relevant to cryptocurrencies? For example, how would they address when the blockchain for a cryptocurrency diverges into different paths (i.e., a "fork"), which could result in different cryptocurrencies with potentially different prices? How and when would funds recognize such information in their NAV?
- What policies would a fund implement to identify, and determine eligibility and acceptability for, newly created cryptocurrencies offered by promoters (e.g., an "air drop")? How might a fund account for those holdings if the fund chooses to claim such cryptocurrencies?
- How would differences among various types of cryptocurrencies impact funds' valuation and accounting policies?
- How would funds consider the impact of market information and any potential manipulation in the underlying cryptocurrency markets on the determination of the settlement price of cryptocurrency futures?

Advisers that wish to invest in the crypto asset space would be well advised to review those questions and arrive at appropriate answers, in consultation with their accounting firms and crypto asset valuation specialists where necessary.

The answers to those questions should then be appropriately reflected in the adviser's compliance policies and procedures.

For a very informative article on the topic of valuation of crypto assets, see Donahue, Ryan, *Rising ICOs Highlight Need for New Valuation Metrics*, Law360 (Nov. 7, 2018), which can be found [here](#).

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[1]See IAA Release No. 2204, 68 Fed. Reg. 74714 (Dec. 17, 2003) at p. 74716.

[2]Although the Blass Letter notes that it addresses issues arising from funds potentially focused on **cryptocurrency**-related products, it goes on to say that "other types of digital assets and related products could present similar issues."

## Related Locations

Chicago

## Related Topics

Crypto Asset

Blockchain

## Related Capabilities

Private Investment Funds

Cryptocurrencies, Digital Assets & Blockchain Technology

## Related Regions

North America

## Related Professionals

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